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Tunisia: Staff Report for the Article IV Consultation

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TUNISIA

Staff Report for the 1999 Article IV Consultation

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August 6, 1999

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Executive Summary

- Tunisia's solid growth performance continued in 1998 (5 percent) despite a contraction of agricultural production. A marked rise in the rate of investment was accompanied by a commensurate increase in the saving rate, and the external current account deficit widened only slightly to 3.4 percent of GDP. Inflation decelerated to 3.1 percent despite significant increases in administered prices. Due to a hardening of borrowing conditions on international markets, the authorities did not tap the markets and reserves declined from 3.1 to 2.6 months of imports at end of 1998. Notwithstanding the strong growth performance, unemployment remained roughly unchanged at 15.6 percent. The outlook for 1999 is for a year of solid growth (6.5 percent) with stable inflation (3.1 percent). The external current account is projected to widen slightly to 3.7 percent.

- Tunisia's strong performance in 1998 and into 1999, especially by regional standards has its roots in a prudent and well balanced macroeconomic stance, aimed at continued fiscal consolidation and disinflation, backed by a solid record of investment in social and physical infrastructure. The limited exposure of the economy to short-term capital flows helped Tunisia weather the turmoil in international capital markets. Structural reforms proceeded on several fronts. Notable progress was made toward restoring banking stability under a restructuring program that included the settlement of nonperforming loans to public and semi-public enterprises (5 percent of GDP). The volume of privatization witnessed a marked acceleration with the sale of two large cement factories for a total of US$380 million. Nonetheless, the state still retains extensive control over economic activity.

- The authorities made a notable effort to increase the transparency of policies, including through the publication of this report, the participation in the IMF pilot project on the transparency of economic policies and the intention to subscribe to the IMF's Special Data Dissemination Standards (SDDS).

- The authorities' growth strategy is closely tied to the strategic decision to open the economy to foreign competition and to the opportunities offered by global integration. The structural widening of the current account deficit requires that fiscal consolidation be accelerated and the main sources of budgetary rigidity (notably the wage bill) be addressed. In the face of financial innovation, monetary policy will need to expand the range of indicators used to gauge inflationary pressures, and interest rate will have to play a more active role in credit allocations. Wage agreements will need to become forward looking, guided by a well-defined official inflation objective. The real exchange rate targeting that has guided exchange rate policy should be expanded to take into account a broader set of competitiveness indicators. The improvement in borrowing conditions should be used to restore a more adequate level of foreign reserves, both in terms of imports and as a ratio to short-term debt. Trade liberalization with the EU should be accelerated and widened on a multilateral basis in order to avoid distortions associated with partial trade liberalization. To increase private sector initiative, the government will need to complete its withdrawal from direct intervention in productive activities including banking, telecommunications, and transport sectors.

I. Introduction

1. Discussions for the 1999 Article IV consultation with Tunisia were held in Tunis during June 3–June 16, 1999. The staff team[1] met with the Ministers of Agriculture, Commerce, Economic Development, Employment, Finance, International Cooperation and Foreign Investment, Social Affairs, and Tourism and Handicrafts; the Governor of Central Bank of Tunisia; other senior government officials, and representatives of the employers' association and the banking and financial sectors.

2. At the conclusion of the last Article IV consultation on June 15, 1998, Executive Directors commended the Tunisian authorities for maintaining macroeconomic stability in 1997 while implementing important structural reforms. They welcomed the progress made in reducing tariff and nontariff barriers to trade, and in strengthening and modernizing the banking sector, but noted that the pace of privatization and price liberalization had remained slow. Directors remarked that the exchange regime had served the country well, but encouraged the authorities to improve competitiveness through accelerated structural reforms. They placed particular emphasis on privatization and price decontrol, further strengthening of the banking system, and easing of labor market rigidities to facilitate the movement of labor toward more dynamic sectors.

3. The Fund and World Bank staff have continued to collaborate closely on Tunisia. The second Economic Competitiveness Adjustment Loan (ECAL II), approved by the Bank's Executive Board in April 1999, with cofinancing from the European Union and the African Development Bank, provides support for the reform of the banking system.

4. Tunisia has taken part in the pilot exercise on transparency of economic policies. In addition to publishing the preliminary conclusions of the Article IV mission, the authorities are also participating in the initiative for the voluntary publication of the staff report.

5. On January 6, 1993 Tunisia accepted the obligations of Article VIII, Sections 2, 3, and 4. Although Tunisia discontinued as of August 1988 the extension of exchange rate guarantees to development banks through the Exchange Rate Guarantee Fund, prior commitments, which involve maturities up to the year 2000, will continue to be honored until 2000 and constitute a multiple currency practice.

6. Presidential and legislative elections are scheduled for October 24, 1999, and President Ben Ali has stated that they would no longer be restricted to candidates from parties with a quorum of representation in parliament; 20 percent of parliamentary seats have also been set aside for the opposition.

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[1]The team included Mr. Gardner (head), Ms. Sampic, Mrs. Sheybani (all MED), Mr. Le Dem (Paris Office), and Mrs. Itam (administrative assistant, MED). Mr. Rouai, Assistant to the Executive Director for Tunisia, participated in the discussions.

II. Background

A. Recent Economic Developments

7. Despite a contraction of agricultural production, GDP growth reached 5 percent in 1998 (Chart 1). Gross fixed capital formation, notably in Tunisia's traditional and new export sectors (textile and leather products, mechanical and electrical goods, and food processing), was the most dynamic component of aggregate demand (Chart 1). Exports of manufactured goods (9 percent increase in volume terms) and tourism receipts (9½ percent nominal growth) were also very buoyant, but the overall contribution of exports to growth was contained by a further deterioration in the terms of trade and declining sales of crude oil and food products. Notwithstanding the marked increase in the investment rate to 27.5 percent of GDP, the external current account deficit widened only slightly to 3.4 percent of GDP thanks to a commensurate increase in the saving rate.

8. Inflation (CPI) was reduced further in 1998, to 3.1 percent, despite the increase in VAT rates (see below) and substantial increases in the prices of public transport and utilities, and in administered prices (8 percent on average for subsidized cereal and edible oil products). Cost pressures due to wage growth of 5–8 percent (depending on the sector) thus appear to have been offset by sufficient gains in productivity and declines in import prices (notably capital goods).

9. Despite the strong growth performance, the unemployment rate has remained roughly unchanged at 15.6 percent. This relatively high level reflects in part the inclusion of nonactive job seekers in the official definition of labor force. Outside of this group, unemployment has been largely concentrated among first-time job seekers and unskilled workers.

10. The limited exposure of the economy to short-term capital flows helped Tunisia weather the turmoil in international capital markets. As in Morocco, Tunisian financial markets were not significantly affected by the large inflow (July 96–July 97) and subsequent outflow (since July 1997) of capital that was experienced by Egypt (Chart 2). As other emerging market economies, however, Tunisia faced a marked hardening of borrowing conditions on international markets.[2] In light of the significant volume of foreign direct investment (FDI) inflows of 1998, linked to the privatization of two large cement factories, the authorities decided to postpone the planned issuance of Eurobonds. This still entailed a decline in reserves to 2.6 months of imports from 3.1 months at the end of 1997.

11. In the second half of 1998, the Tunisian stock exchange began recovering part of the losses sustained over the previous two years. By the end of the year, market capitalization stood at 11 percent of GDP, still considerably lower than its peak of 23 percent of GDP in 1995. Foreign investors accounted for half of total trading volume in 1998 and held 20 percent of

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[2]Tunisia's ratings are BAA3 (Moody's), BBB- (IBCA), BBB+ (WBRI), Mid BBB (Morgan Stanley), and BB+ (Thomson Bank Watch).

market capitalization. Over the first six months of 1999, the stock market index rose by 26 percent—but only by 5 percent in U.S. dollar terms.

12. As of end-1998, Tunisia had a sizeable but sustainable external debt amounting to US$11.3 billion (55 percent of GDP, as compared to 61 percent a year earlier). Public and publicly-guaranteed debt, mostly medium and long term, accounted for 80 percent of the total. Short-term debt (US$1.6 billion) was mostly contracted by the private sector, a quarter of it in the form of trade credits.

B. Recent Policy Developments

13. Since 1996, Tunisia has experienced a leap in trend growth to an average of 6 percent per year. This strong performance, especially by regional standards, has its roots in a prudent and well-balanced macroeconomic policy stance, aimed at continued fiscal consolidation and disinflation, cast in a medium-term framework (Box 1) and backed by a solid record of investment in social and physical infrastructure—expenditure on health and education have averaged 8½ percent of GDP. Structural reforms have been proceeding at a cautious but steady pace; however, the state retains extensive control over economic activity.

14. Considerable progress was made on the fiscal front (Chart 3). The consolidated central government deficit (excluding privatization and foreign grants) was narrowed from 4.2 percent of GDP in 1997 to 2.8 percent in 1998 (below the 3 percent fiscal target). An increase in the social security surplus accounts for a third of the improvement (0.4 percent of GDP). The remaining improvement (0.8 percent of GDP) is attributable about equally to new tax measures and to a decline in interest payments. Tax revenues were increased despite the effects of trade tariff reductions, thanks to a hike in the main VAT rate (from 17 to 18 percent), the expansion of its base, and the introduction of withholding at source (on selected VAT and income tax obligations) to improve tax compliance. Budgetary outlays for generalized food subsidies were held in check through increases in the prices of subsidized goods.

15. The level of privatization receipts (1.8 percent of GDP) made it possible to reduce domestic debt financing, even in the absence of new net external financing. Domestic debt management was modernized with the introduction of new fungible bond issues in March 1999 (*Bons du Trésor assimilables, BTA*).[3]

16. Monetary policy attained the objectives that had been set for 1998 (Chart 4). The growth of the liquidity aggregate M4 leveled off below nominal GDP growth.[4] The central bank's official

[3]Fungibility is achieved by reopening existing lines at successive auctions. This permits the formation of a sizable stock of identical securities in the market.

[4]M4 includes broad money, transferable treasury bills (*bons du Trésor cessibles*) that have been the object of repurchase operations between banks and the public, and commercial paper. The inclusion of commercial paper reflects the fact that it has been used as a substitute for bank overdrafts. The replacement of the *bons du Trésor cessibles* by the new BTAs will destabilize M4 in 1999.

interest rate, unchanged since March 1997, was maintained at 6.875 throughout 1998. It was lowered by 100 basis points in February 1999.

17. Structural reforms proceeded on several fronts. Notable progress was made toward restoring banking stability under a restructuring program, developed with the support of the World Bank (Box 2), the main features of which were the clean-up of bad loans to public enterprises, the strengthening of the prudential framework, and banking restructuring through the prospective merger of government-owned state banks. Still, as of end of 1998, the ratio of nonperforming loans to GDP (to the private sector) stood at 22 percent of GDP.

18. The industrial restructuring *(mise à niveau)* program launched in 1996 to prepare private manufacturing enterprises for the liberalization of markets and European competition has yielded some positive results (Box 3). Over three years, total investment of around TD 1 billion (US$920 million) has been approved toward upgrading productive capacity and human capital, supported by grants of TD 135 million, with notable successes in terms of improved export performance and jobs created (or saved).

19. The volume of privatization witnessed a marked acceleration in 1998, with the sale of two large cement factories to foreign investors for a total of US$380 million (TD 418 million). However, state-owned enterprises still accounted for around 20 percent of value added in 1998 (Box 4). The government also continued to withdraw from the productive sectors with the granting of the first concession for the private production of electricity and the opening of certain port handling activities to private competition.

20. Social indicators have been outstanding by regional standards, notably in terms of education, gender gap, health provision, and housing—some 80 percent of the population own their home. However, the information available dates back to 1995 and the World Bank is in the process of updating it. Still, social problems remain, notably as concerns the unemployment rate (15½ percent) and the school dropout rate (8 percent of school-age children are out of school).

III. Policy Discussions

A. Short-Term Prospects and Policy Objectives

21. The positive macroeconomic results of 1998 should be consolidated in 1999, with growth rising to 6½ percent. Part of the acceleration in growth may be temporary, reflecting the good crop year and the diversion of some Mediterranean tourism toward Tunisia, on account of the war in the Balkans and security concerns in Turkey. Still, domestic demand remains very vibrant and gross fixed capital formation is projected to increase by 12 percent (in volume terms) boosting the investment rate to nearly 29 percent of GDP. By contrast, exports of manufactured goods are expected to grow at only a moderate pace (4.5 percent in volume terms).

22. The inflation rate is projected to remain roughly stable, at around 3 percent per year. The relatively moderate private sector wage increases negotiated in June 1999 (3½–4½ percent annual increases for the period 1999–2001) should not be a source of new inflationary pressures,

provided productivity growth follows recent trends (around 1.5 percent per year on average from 1994 to 1997).

23. The external current account deficit should widen slightly to 3.7 percent of GDP in 1999, despite a projected upturn in the terms of trade. Cyclical and structural factors alike account for this development, including Tunisia's relative cyclical position, the projected rise in the investment rate, and the trend deterioration in the energy balance. Encouragingly, the national saving rate is also expected to rise further in 1999, notably on account of increased public saving.

24. The prudent stance of fiscal policy is reaffirmed in the objectives set for 1999 and the measures deployed to reach them. The consolidated fiscal deficit for 1999 is projected at 2.6 percent of GDP. Expected, but unbudgeted, increases in outlays related to public sector wage hikes should be compensated by the increase in fuel excises of April 1999 and by the substantial saving that will be realized on food subsidies (0.3 percent of GDP) due to the drop in the price of food imports. Tax revenue performance has been buoyed by the administrative measures taken in 1998, and additional measures were taken in 1999 including an audit of outstanding VAT credits and the simplification of the tax regime for small businesses.[5]

25. Because of delays accumulated in the privatization of the remaining public cement enterprises, the financing need of the government will be larger than initially projected. Still, at just over 2 percent of GDP, it is not a source of concern. The government debt to GDP ratio should remain on a clear downward path except for the effect of the take over by the state of the nonperforming loans to public enterprises (Box 2). With the introduction of new debt instruments (BTA), sold through auctions, the authorities also hope that the government's net borrowing requirement in 1999 will be met without recourse to additional bank financing. This modernization should lead to the development of a genuine secondary market in government paper, but the mission noted that a more rapid improvement could be achieved by extending this technique to short-term bills, by authorizing banks to participate directly in the primary and secondary markets, and by standing ready to accept higher yields in the primary market.

26. Monetary policy in 1999 continues to be guided by quantitative targets. As in the past, the authorities chose to focus on a credit aggregate, by setting the target rate of credit expansion to nongovernment at one percentage point below nominal GDP. Given the projected changes in foreign reserves and net credit to government, the credit target GDP corresponds in effect to setting the broad money growth at the rate of nominal GDP growth.[6] The mission urged the authorities to monitor more closely both narrow money and a broader liquidity aggregate (as a

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[5]For enterprises and self-employed individuals with gross revenues under TD 30,000 (covering about 250,000 taxpayers), a flat rate based on gross revenues replaces the previous system based on gross revenues, number of employees, location and other parameters. Taxpayers with gross revenues in excess of TD 30,000 but below TD 100,000, can opt for a lump-sum tax of TD 1,500 per year.

[6]With limited capital mobility and a preset foreign reserve objective (as well as a predetermined exchange rate, at least in the short run), fluctuations in money demand are fully reflected in variations in domestic credit, and vice-versa.

replacement for M4), since these aggregates were unlikely to be as affected by recent and prospective portfolio shifts,[7] and should provide a better measure of potential inflationary risks.

27. While the authorities maintain a reserve objective of three months of imports, they plan to reach it only by the end of 2000. Owing to the deterioration of the current account balance and expected delays in privatization operations in 1999, only limited progress will be made toward that objective in the current year. On the basis of current projections and gross new market borrowing of some US$500 million, reserves should rise to around US$2.0 billion, or 2.7 months of imports (c.i.f. prices) by end-1999. The authorities indicated that, in the context of the Y2K problem, they intended to complete their external-borrowing program for 1999 by September or October.

28. A 10-year bond issue of € 250 million, issued in mid-July at a spread of 280 b.p. (over equivalent German Bunds), confirms that borrowing conditions have improved markedly over 1998, when Tunisia was quoted spreads around or in excess of 400 b.p. Even so, this represents an increase in debt servicing costs relative to those prevailing before the Asian financial crisis. The mission took the view that, in managing the country's external debt and foreign reserve position, the authorities should not count on a further easing of borrowing conditions on international markets in the near future.

29. The widening current account deficit and a peak in debt service payments falling due in 2000 (about US$550 million) will require a significant increase in foreign borrowing in 2000, if the reserve objective is to be attained. Even with a resumption of large-scale privatizations, the authorities will need to tap international capital markets for about US$800 million, still below the level of 1997. Medium- and long-term external debt would increase to about US$10.4 billion, but would remain unchanged as a ratio to GDP (see below for a discussion of the medium-term scenario).

30. The mission supported the authorities reserve objective and related foreign borrowing program, but emphasized that the adequacy of foreign reserves should also be measured in relation to the level of external indebtedness, particularly short-term debt.[8] In this regard, the ratio of short-term debt (including debt maturing within a year) to reserves may appear to be quite high, at 144 percent in December 1998, but much of that debt is made up of deposits in the domestic banking system (e.g., convertible deposits of Tunisians working abroad, and working balances of offshore companies and tour operators) that are very stable in nature. Excluding such deposits, the ratio of short-term debt to reserves falls to 105 percent (49 percent excluding amortization falling due). The mission pointed out that even these otherwise stable deposits can,

[7]The development of mutual funds and short-term negotiable instruments, as well as the replacement of the *bons du Trésor cessibles* by the BTA are more likely to affect quasi money than narrow money. A broad liquidity aggregate that would include these new financial instruments will similarly be less sensitive to portfolio shifts among them.

[8]The ratio of foreign exchange reserves to broad money is not as relevant as an indicator of vulnerability for Tunisia, because of the nonconvertibility of residents' money balances.

under adverse circumstances, be subject to sudden withdrawals and thus become a destabilizing factor, and urged the authorities to monitor closely these ratios. The mission was reassured that official reserves were not undermined by any potential liability.

B. Medium-Term Challenges

31. The authorities' objectives through 2001, as implied by the IXth Economic Development Plan, are to maintain a trend growth of 6½ percent and begin reducing the unemployment rate as of 2000. No specific macroeconomic objectives have been set beyond the end of the IXth Economic Development Plan, but a stabilization of growth around this trend could be achieved building on the opportunities created by the opening of the economy and its closer integration with Europe. In order to achieve these objectives, however, the authorities will have to meet the following challenges:

- **Strengthening the economy's competitiveness** in the face of trade liberalization with the European Union (Box 5), and the gradual elimination of textile quotas which will increase Tunisia's competitors' access to European markets, and against an observed weakening of export growth relative to 1998, and a loss of market share in the EU relative to competitors from Asia and Eastern Europe (Chart 6).
- **Preserving the stability of the country's external accounts and reestablishing a comfortable level of reserves**, against a structural widening of the current account deficit in 2000–01, linked to the investment needs of the economy and trade liberalization with Europe. Along with these pressures on the current account, Tunisia will need to rollover a considerable amount of external debt at less favorable terms than it had been able to secure before the Asian financial crisis.
- **Maintaining a fiscal stance consistent with a declining public-debt ratio**, despite the trend decline in trade tariffs and the cost of taking over the bad debts of public enterprises.
- **Consolidating the disinflation gains achieved in 1998–99** in an environment in which prices are to be increasingly determined by market forces.
- **Building the private sector's capacity to adapt** to changing market conditions, in order to improve the resilience of enterprises and therefore the security of jobs.
- **Enhancing the banking system's capacity to manage the risks** that are inherent in an open market economy, in order to minimize financing costs and reinforce the soundness of the banking system.

C. Policy Requirements for the Medium Term

Public finances

32. The mission underscored the importance of pursuing fiscal consolidation as a way to contain the projected widening of the external account deficit and to create sufficient room for maneuver in the event of an adverse shock to economic activity. Budgetary retrenchment was also

needed to help offset the structural deterioration in the social security accounts linked to demographic factors.

33. The authorities indicated that the IXth Economic Development Plan would be guiding budgetary policy through 2001, implying a budget deficit target of 2.5 percent in 2000, and 2 percent in 2001, including privatization revenues and grants. According to the mission, fiscal policy design would be improved if it were based on a rolling medium-term forecast (updated at every budget cycle) rather than on the unchanged assumptions contained in five-yearly Economic Development Plans.

34. The mission endorsed the authorities medium-term budgetary target, provided the fiscal deficit (excluding privatization) was kept on a clear downward path. In this regard, the adjustment required to reach the objective set for 2001 could be accelerated by setting a more ambitious deficit target for 2000 than envisaged under the IXth Economic Development Plan. The mission noted that government expenditures financed by privatization receipts were more akin to debt financing than tax financing, in terms of their macroeconomic and current account impact.[9] Accordingly, any increase in privatization revenue relative to the plan should be earmarked for debt reduction. The authorities took the view that, as a stock operation, privatization revenue could legitimately be used for capital expenditure. They indicated that, in any case, only a part of privatization receipts would be earmarked to public investment, as had been the case with the creation of the Road Fund in 1998.

35. Because of the projected decline in trade tariff revenues (2.1 percent of GDP cumulatively through 2004) and the reduced margin for compressing discretionary current expenditures (the wage bill and interest alone account for 70 percent of current expenditures), the authorities recognized that continued fiscal retrenchment would require strong action on several fronts.

36. On the revenue side, the main objective is to stabilize the tax to GDP ratio. In light of the success of the administrative measures taken in 1998–99, the authorities expected that tax collection could be further boosted through such actions. While there is indeed scope for better-targeted tax audits,[10] the mission doubted that administrative measures alone could fill the gap. Before raising tax rates that are already relatively high (for both VAT and direct taxes), the mission encouraged the authorities to expand the tax base by reducing tax expenditures, estimated

[9] In the presence of Ricardian equivalence, of course, debt, tax and privatization financing would all be equivalent.

[10] For instance, the recent law providing tax incentives to companies that apply for a stock market listing should help increase accounting transparency and improve the effectiveness of tax audits.

at around 1 percent of GDP. It urged the authorities to assess more systematically the fiscal cost of tax expenditures and their effectiveness in achieving the desired objectives.[11]

37. On the expenditure side, the mission welcomed the progress made in reducing expenditure on generalized food subsidies to 1.7 percent of GDP in 1998, from 2.2 percent in 1996. The authorities noted that they had in fact already reached the target set for 2001 and that further real reductions would be achieved by raising prices as necessary to cap nominal expenditures at the level of the 1999 budget.[12] The mission suggested that the current low level of import prices afforded the opportunity to move even faster, by adjusting the budgetary ceiling downward to the level of actual expenditure (for an additional saving of about 0.3 percent of GDP in 2000) and to lower it further whenever food subsidies fell short of the budgeted amount.

38. In the final analysis, the main obstacle to reducing government current expenditure lies in the weight and rigidity of the government wage bill (11 percent of GDP). In 1998, the wage bill grew by 9 percent roughly in line with GDP. Net new hiring in the social sectors accounted for about a third of that increase. On present policies, it is unlikely that, in the near term, the wage bill will decline to any significant degree in relation to GDP. The mission suggested that it might at least be possible to limit net hiring by not filling positions vacated by retirees in low-priority sectors. The authorities indicated that they had already done so in certain ministries but that pressures for new personnel in social sectors made it difficult to limit net recruitment. The authorities were also exploring possibilities for redeployment. In the end, however, the mission insisted that a lasting reduction in the wage bill, consistent with enhanced government efficiency, can only be achieved through a comprehensive civil service reform.[13]

39. The balance of the social security accounts will be deteriorating steadily in the years ahead under demographic pressures. The public sector fund will be in deficit as of 2000, and the fund covering the private sector will face enormous strains starting in 2012–13. Far-reaching reforms are called for to ensure the long-term viability of the funds. The authorities indicated that a reform of the health insurance system (delegating some of the responsibilities to private insurance) will be phased-in starting in 2000, and that an actuarial study of the pension system was nearly completed and would be followed by reform proposals in 2000.

40. Direct operating subsidies to public enterprises are negligible and the enterprises' ability to build up extensive new arrears to the banking sector should be curbed by the recent reinforcement

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[11]For instance, exemptions from corporate income tax have no particular effect on foreign investment if, in the absence of a specific bilateral agreement, the repatriated profits are taxed by the country of residence of the foreign enterprise at the same (or higher) rate than they would have been in Tunisia. The exemption amounts in this case to a simple transfer of Tunisian tax revenues to the budget of the country of origin.

[12]The savings generated by the increases in subsidized food prices are redirected, in part, to increase transfers to poor families. Presently 150,000 families are targeted under these programs.

[13]World Bank involvement on this issue has thus far been limited to a preliminary diagnostic study carried out in 1994.

of the prudential and regulatory framework. Still, the mission noted that inadequate information on the financial and economic performance of public enterprises, including the nature of their quasi-fiscal activities, exposes the budget to an unknown financial risk.

41. Special funds, including those created in 1999,[14] account for about 5 percent of budgetary expenditures. Although these funds are part of the budget law and therefore do not impair fiscal transparency, they are not subject to annual appropriations. As such, the mission warned, they could become a source of fiscal rigidity and an obstacle to fiscal retrenchment, especially as concerns funds that finance recurrent expenditures. The authorities countered that the creation of a fund with earmarked revenues may actually facilitate the voting of supplementary revenue.

Competitiveness and the exchange rate policy

42. The authorities had long recognized the challenge posed by trade liberalization with Europe and the forthcoming dismantling of the textile quotas, and expected Tunisia to remain competitive and to retain a comparative advantage in its traditional export areas (textiles, tourism and, increasingly, mechanical and electrical parts) by moving upmarket, and offering higher quality products and services. They noted that the *mise à niveau* program had already succeeded in restructuring a number of enterprises in this direction and that Tunisia possessed the labor skills to upgrade the quality of production. Also, the proximity to Europe had not yet been fully exploited (because of prohibitively high tariffs in the protected transportation sector), mass tourism was gaining competitiveness relative to destinations in Europe, and there was still a large untapped potential for higher value-added (cultural and desert) tourism.

43. It was agreed that the exchange rate policy would continue to play a crucial role in preserving price competitiveness, thereby promoting the upgrading of the economy and export diversification. Exchange rate policy has been guided by a fixed real exchange rate objective based on a basket of competitor and partner countries (Chart 5).[15] The mission observed that this exchange rate policy could not offset the effects of competitiveness shocks (other than those related to relative CPIs), such as the effects of trade tariff reductions with the EU and the dismantling of the textile quotas, which might justify additional discretionary adjustments.[16] The mission suggested that exchange rate policy should be guided by a broader range of indicators such as developments in relative market shares, and in relative unit labor costs. The staff noted that Tunisia had been losing market share in the EU relative to competitors from Asia and Eastern

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[14]*Fonds d'incitation à l'innovation dans les technologies de l'information*, *Fonds de développement des autoroutes*, and the *Fonds de développement des communications*.

[15]This rule is interpreted flexibly by the central bank, which may allow the real exchange rate to deviate from the target rate in order to smooth movements in nominal exchange rates. Information on the basket is not disclosed.

[16]In fact, because of downward price pressures generated by trade liberalization with Europe, competitiveness as measured by a real effective exchange rate index (in terms of CPIs) may actually appear to improve with liberalization.

Europe, although it was still gaining in the textile sector (Chart 6). According to the authorities, their exchange rate policy afforded them the flexibility to take these additional factors into consideration, although until now they had been constrained by the lack of adequate statistical information (notably as concerns unit labor costs). They stressed that, in any case, they would limit exchange rate adjustments to correcting for observed losses in competitiveness.

Inflation and wage policy

44. With the exchange rate instrument assigned to maintaining external price competitiveness, the reduction of inflation and its stabilization at a low rate have had to rely on prudent incomes and monetary policies. Wage increases at the sectoral level have been set every three years in the context of tripartite wage negotiations, with the government playing a facilitating role. The wage increases of 1996–98 (5–8 percent a year, depending on the sector) were accompanied by sufficiently strong productivity growth to reduce inflation to about 3 percent. Similarly, inflationary trends over the next three years will be largely determined by the wage increases negotiated in June 1999 (3½–4½ percent a year) and the productivity gains achieved over the period covered by the agreements (through 2001). Although there is no formal indexation, wage negotiations tend to be backward-looking and, thereby, introduce a large element of inertia in the wage-setting process. In the event, the low inflation observed in 1997–98 actually contributed to containing wage increases during the recent round of negotiations. Against this background, a role of monetary policy has been to avoid creating additional inflationary pressures through excessive monetary or credit growth.

45. The mission agreed with the authorities that this price-setting mechanism has served the economy well from a macroeconomic standpoint: all the while permitting rapid and durable disinflation, it has guaranteed a high degree of social stability, which has, itself, been a source of productivity growth. The mission noted, however, that the system lacked a clear nominal anchor, and that it would be desirable for forward-looking wage negotiations to be guided by medium-term inflation targets updated on a regular basis. The need to anchor inflationary expectations will be all the more important in a context of greater price liberalization (see below). The mission also stressed that, with the uncertainties surrounding the opening to international competition, it was important to give individual enterprises greater leeway (within sectoral collective agreements) to adapt wage remuneration to their particular circumstances.

Monetary policy targets and instruments

46. Because of limited capital mobility, exchange rate policy has not impinged on the independence of monetary policy. Monetary policy has supported the marked reduction in inflation by ensuring prudent annual growths of credit and monetary aggregates. As noted above, financial innovation is bound to undermine the effectiveness of monetary targeting in the years ahead. The mission suggested that the present framework could be made more flexible by adjusting the monetary objective within a target range, on the basis of additional indicators of inflationary pressures, as measured, for instance, by an index of nonadministered prices, and asset price indices.

47. At present, the interest rate does not play a very active role in the conduct of monetary policy. The one percentage point reduction in the central bank repurchase rate in February 1999 did not appear to be linked directly to the attainment of the intermediate objectives of monetary policy. The authorities explained that the interest rate reduction was intended to bring the real interest rate back to the level prevailing earlier in 1998, and closer to the level observed in trading partners and competitors. In any case, the mission noted that, in the absence of an efficient interbank market, the money market rate failed to provide a true measure of the marginal cost of money. The attainment of the central bank's quantitative monetary and credit objectives has relied partly on constraining the volume of refinancing (at a given price) rather than on adjusting the interest rate. The authorities explained that this allocation mechanism was better suited to the state of development of the banking system and its ability to manage risk.[17]

48. The mission took the view that, with the progressive strengthening of the banking system, it would be desirable for the interest rate to play a more active role in credit allocation and to become the main instrument of monetary control (Box 6). Development of an active money market would of course increase the volatility of the money-market rate, but movement in the interbank rate—for instance within a corridor defined by a floor rate and a ceiling rate—would provide useful information on market pressures, enabling the central bank to improve monetary control.

49. For interest rates to play a stronger role, the money market must be developed. Steps have already been taken to that end, with the introduction of auctioned fungible treasury bonds (5- and 10-year maturities) and the adoption by the Council of Ministers of a revised central bank charter, which will enable it to intervene more easily in the treasury-bill market and to conduct open-market operations and repurchase operations. The mission also made a number of technical recommendations to support the development of the money market, including: enlarging the range of eligible guarantees for refinancing operations, introducing repurchase agreements, removing restrictions on negotiable securities,[18] extending the coverage of the settlement/delivery system, and reducing restrictions on the remuneration of deposits of less than three-month maturity.

Structural reforms

50. Besides improving productivity, the return to capital and thereby investment, structural reforms are essential to making the economy more flexible and more easily adaptable to the opportunities and the risks inherent in an open-market economy. It is particularly important that the private sector be able to assess for itself these opportunities and manage the risks. The

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[17]Lending rates are freely determined, except for the loans by the *Banque Tunisienne de Solidarité* and those financed out of housing savings accounts (*livrets d'épargne logement*). Deposit rates are free, except for sight deposits (up to three months) whose remuneration is capped at 2 percent, and specific savings accounts.

[18]Such as requiring bank guarantees for commercial paper, prohibiting the repurchase of securities by the paying agent, restricting the secondary market to banks, and requiring a minimum maturity of 90 days for certificates of deposit.

industrial restructuring (*mise à niveau*) and labor training/retraining programs have been very successful in this regard: by implicating the private sector (both financially and in terms of project design) they have contributed to raising productivity and private sector competence. The government will continue to play an important role in this domain as well as in ensuring the smooth functioning of markets.

51. On the other hand, the private sector will be able to play a more dynamic role only if the government moves more quickly to reduce its direct involvement in the economy. The mission argued that social considerations should not lead one to underestimate the latitude that exists for accelerating economic liberalization. Distortions induced by differences in the pace of liberalization across sectors adversely affect the efficiency of the economy. The staff recommended that more decisive action be taken in the following areas:

52. ***Privatization and demonopolization.*** Though the process of privatization continues, the delays accumulated in 1999 could penalize growth. The authorities assured the staff that these delays were purely related to measures taken to make the process more transparent and that there was no weakening of political commitment. It was therefore hoped that the delays would be made up for in 2000–01. The mission urged the authorities to broaden the scope of privatization to the sectors deemed strategic, such as telecommunications, banking, and transport. In addition to the well-known efficiency arguments, the mission stressed that privatization (to foreign investors) could ease the financing of the external current account deficit. The transfer of public enterprises to the private sector would also ensure the commercial viability of their investments, and thereby the soundness of the underlying bank financing. To be successful, privatization must of course be accompanied by the liberalization of prices and profit margins. There is indeed still ample scope for liberalization, given that one third of the CPI is still under administrative controls.

53. ***Trade policy.*** The mission recommended advancing the remaining phases of trade tariff dismantling with the EU in order to limit the distortions created by the increase in the effective rate of protection that accompanied the first phase of trade liberalization with the EU. It underscored that these distortions can be costly not only in terms of efficiency losses but also in terms of the subsequent cost of reconversion of human and capital resources, diverted to sectors benefiting from a temporary increase in the rate of effective protection. The authorities have begun a process of regional trade liberalization, with free-trade agreements with Jordan, Morocco, and Egypt. The mission encouraged Tunisia to continue in this direction by taking advantage of the political opening-up in neighboring countries, with a view to establishing a genuine single market in the Arab Maghreb Union. This should enhance Tunisia's attractiveness to foreign direct investors wanting to operate in this market. However, in view of Tunisia's restrictive most favorite nations' trade regime,[19] regional trade integration could create serious distortions from trade diversion if it were not accompanied by across-the-board and multilateral tariff reductions. The mission regretted that steps toward the planned lowering of the average tariff rate from 33.6 percent presently to 25 percent were not taken by the budget law of 1999 and

[19]Tunisa's trade regime has a rating of 8 (on a scale of 1 to 10) in the Fund's overall trade restrictiveness index.

recommended that a plan to that effect be adopted as soon as possible so that measures can be implemented by 2000.

54. ***Strengthening the banking and financial systems.*** Significant strides have been made, particularly with the measures taken in 1998–99, toward putting the banking system on a sounder footing. Still, asset quality remains poor, with bad loans to the private sector amounting to 22 percent of GDP. The adoption of regulatory and tax measures facilitating the recovery of collateral, the write-off of nonperforming loans and provisioning have created the conditions for reabsorbing, over time, the burden of these bad loans. According to some bankers, the recovery of collateral could reach 60 percent of nonperforming loans; and the rate of default on new loans has been very low—of course, this reflects the strength of the economy over the last few years, and may change with the opening of the economy to European competition.[20] The mission recommended to further simplify the unduly lengthy procedures for the court-ordered liquidation of companies, as envisaged in the draft amendment of the 1995 law on rehabilitating problem companies.

55. The mission also urged the authorities to avoid assuming responsibility for remaining or new nonperforming loans, and to strengthen the credit culture at all levels. The recent initiative to cancel the debt of small farmers is justified from a social point of view, but it is important to ensure that the conditions that led to the problem in the first place do not recur.[21] The mission was reassured by the proposed reforms directed at making assistance to farmers more transparent and efficient.[22] The central bank was confident that improvements in prudential regulations and banking supervision would also curb significantly the risks of accumulating new bad loans to public enterprises.

56. More generally, the banking system needs to upgrade its risk-management practices. This process can be accelerated by privatizing public banks and attracting foreign partners.[23] There is also a need to consolidate the excessive number of banks, particularly in light of the recent adoption of a universal banking charter. Such reforms will require massive divestiture by the state,

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[20]The creation of a central bank database on banks' clients (*centrale d'information*) should also allow new credit to be extended on a more informed basis.

[21]Under a draft law approved by the Council of Ministers, the budget would take over the debts of small farmers incurred before end-1998 (i.e., initial loans of under TD 2,000), as well as part of the interest due on loans of under TD 40,000. The operation will benefit 164,000 farmers, for a total budgetary cost of TD 200 million (0.8 percent of GDP) to be spread over time.

[22]Notably, by providing budgetary support to small farmers through microcredits and by developing insurance schemes for larger scale farming.

[23]Public banks are presently not on the list of enterprises slated for privatization. The government remains committed to the gradual liberalization of financial services vis-à-vis the EU and in the context of the service liberalization protocol at the WTO.

which still controls the two largest commercial banks, accounting for around one third of total assets, and over half of the sector more generally.

57. The authorities underscored the efforts undertaken in 1998 to strengthen the stock market with the introduction of a weighted (and more informative) price index and real-time quotation of shares in Reuters. Substantial tax incentives to float and to hold shares were also announced in February 1999.[24] These measures may explain part of the strength of the recovery in equity prices since the beginning of the year. It was also hoped that they would broaden the capitalization of the stock market—at present, the six largest enterprises represent 40 percent of total capitalization, and banks account for 60 percent of total capitalization.

58. ***Employment.*** The industrial restructuring called for by the opening up of the Tunisian economy to foreign competition will lead to some job losses. Indeed, the authorities noted that the loss of a job had begun to appear more frequently as a cause of unemployment. Having observed the adverse effects of unemployment insurance in Europe, the authorities said that they did not intend to introduce passive support schemes, but would rather expand active labor-market policies. A promising such scheme has been the introduction of a computerized job search system accessible to the public through internet. The mission noted that, with the changing nature of unemployment, it will be necessary to expand training and reintegration mechanisms so as to limit the duration of unemployment.

59. ***Education.*** Tunisia's high literacy rate attests to the success of its education policy. The mission noted, however, that educational achievement was being undermined by a high dropout rate at the primary level of education. The authorities' intention to address this problem should enable the school system to better meet employers' need for skilled labor. A better integration of the higher education system with private sector requirements would also improve the school-to-work transition.

IV. Medium-Term Scenario

60. The main difficulty in projecting Tunisia's macroeconomic performance over the medium term lies in assessing the future impact of trade integration with the EU and of the accompanying measures on Tunisia's competitiveness, trade performance, and GDP growth. Building on the above discussions, the medium-term scenario assumes continued fiscal consolidation, pursuit of an exchange rate policy compatible with protecting external competitiveness, and a deepening of structural reforms to facilitate the reallocation of resources toward viable export industries and away from import-substitution and public enterprises. The main features of the medium-term scenario are as follows:

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[24]These include: a reduction of the corporate income tax rate from 35 to 20 percent over a five-year period for enterprises floating at least 30 percent of their stock on the market; the deductibility of provisions created by institutional investors against capital losses in the stock market; and the creation of tax deductions on individual accounts invested in listed shares.

- GDP growth stabilizes at 6 percent.
- The growth of total exports, in volume terms, accelerates from 3.6 percent in 1999 to 6.4 percent by 2003, owing to improvements in competitiveness (from industrial restructuring, privatization, and market liberalization) as well as sustained increases in capacity; the growth of manufactured goods exports rises from 4.5 percent in 1999 to 7.5 percent in 2004; tourism and textiles continue to be the main sources of export growth, but exports of mechanical and electrical goods should experience even faster growth, albeit from a smaller base.
- Despite the tightening of fiscal policy, the growth of imports outpaces that of exports until 2002, owing to trade liberalization and the strength of investment.
- The external current account deficit peaks at 3.9 percent of GDP in 2001, declining thereafter to the level of 1999; the one percentage point increase in the investment to GDP ratio over the period is thus roughly matched by an equivalent increase in the national saving rate.
- Government investment remains unchanged in percent of GDP, and the tax to GDP ratio is stabilized through new tax measures; the consolidated fiscal deficit is reduced by nearly 2 percent of GDP through reductions in current expenditures and transfers. Strong growth and fiscal consolidation lead to a rapid reduction in the government debt to GDP ratio, from 55 percent in 1999 to 40 percent in 2004.
- The increase in government saving (by 2 percent of GDP through 2004) offsets a one percentage point decline in the private saving to GDP ratio (in 2000–01), built into the framework to account for possible effect of trade liberalization, Ricardian equivalence, and the potential growth in consumer credit.
- Reflecting in part an accelerated pace of privatization, net FDI inflows are projected to rise to US$530 million a year, on average, over the period 2000–04, compared with US$430 million over 1996–99.
- In order to maintain the level of official reserves at three months of imports, total gross new external borrowing (medium- and long-term) rises from US$1.6 billion in 1999 to US$2.0 billion in 2000, stabilizing at roughly that level over the medium term.
- Total external debt declines moderately, from 53.2 percent of GDP in 1999 to 49.2 percent in 2004; the debt-service ratio peaks in 2000 at 21 percent of exports of goods and services, and declines thereafter to an average level of just over 17 percent.

V. Transparency, Statistics and Y2K Readiness

61. The authorities have recently embarked on a broad-based effort to increase the transparency of policies, which has included participation in the IMF's pilot project on the transparency of economic policies, the publication of the preliminary conclusions of the Article IV mission, and participation in the voluntary program for the release of the staff report.

62. Preliminary findings of the transparency report suggest that Tunisia has made considerable progress toward transparency; nevertheless, improvements could be made in a number of areas. More details will be available in the forthcoming report.

63. The authorities' target date for subscribing to the SDDS is end-2000. The Fund will continue to provide technical assistance in support of this effort. In the meantime, the authorities adopted in April 1999 a new statistics law based on international best practice. The authorities have also improved the dissemination of statistical and policy information on the worldwide web, including information on privatization and central bank regulation on banking and monetary policy. The Tunisian authorities regularly provide economic and financial statistics to both MED and STA, allowing for regular surveillance. However, deficiencies persist in the provision of information on public enterprises, local government finances, and wages.

64. Tunisia has been concerned by the Y2K problem since 1997, and has put in place all the necessary structures to prepare the country for a smooth transition to January 1, 2000. The financial sector, government agencies, and all infrastructures are practically ready. The government is in the process of completing national contingency plans. A program is also under way to help small- and medium-sized enterprises towards Y2K compliance. It is unlikely, however, that all of them will be fully compliant before the end of the year.

VI. Staff Appraisal

65. Tunisia's steady and strong growth performance, achieved in a context of low inflation and external stability, is commendable, particularly set against the financial instability that has beset emerging market economies and the slack of growth in Europe, Tunisia's main export market.

66. The underpinnings of this performance are to be found in a prudent and consistent macroeconomic policy management, grounded in a medium-term framework and effective policy coordination. This coordination has contributed to the clarity of objectives and to their effective implementation. Sound macroeconomic policies have been accompanied by a steady, if at times hesitant, program of structural reforms.

67. The importance ascribed by the authorities over the years to social development and to the growth of human capital is also a determining factor in Tunisia's economic success, as witnessed by the remarkable achievements registered in terms of literacy, health, gender gap, and housing. Even so, unemployment remains a serious social problem.

68. The authorities' objective of maintaining trend growth at 6½ percent is closely tied to the strategic decision they have taken to open Tunisia's economy to foreign competition and to the opportunities global integration has to offer. Having embarked on a path of gradual trade liberalization with the European Union, it would be desirable to accelerate this process and to broaden it on a multilateral basis, in order to avoid the potential distortions associated with partial trade liberalization, including the adverse effects of a transitory increase in effective protection.

69. The growth strategy described above is not without risks. The dismantling of trade tariffs will require a considerable amount of industrial restructuring and upgrading in order to strengthen the economy's competitiveness, all the more so in a context where export growth appears to be weakening. Trade liberalization and the investments required to restructure the economy will also put additional strains on the external current account. A widening of the external current account deficit to just under 4 percent is still consistent with a declining external debt ratio, and thus viable over the medium term, provided it is motivated by a strong growth in investment.

70. The stability of the macroeconomic framework remains the essential prerequisite to growth. The government's demonstrated ability to take decisive actions to preserve that stability is very encouraging in this respect. Still, bold fiscal and structural measures are necessary to meet the challenges of global integration, as will a more fundamental rethinking of the role of the state in the economy.

71. Fiscal consolidation will play an essential role in containing the structural widening of the current account deficit, and thereby external indebtedness. It also responds to the need to create a precautionary cushion against unforeseen events and to offset the trend deterioration in the social security accounts. The staff endorses the authorities' medium-term deficit reduction target but recommends that the required adjustment be moved forward by aiming for a lower deficit target in 2000, than originally envisioned. It is also important that additional privatization receipts that may be generated (relative to the medium-term plan) be earmarked for debt reduction and not for new expenditures. Having largely exhausted the scope for compressing discretionary expenditures, the authorities will need to address the main source of budgetary rigidity, namely the wage bill and the extensive system of tax exemptions.

72. The exchange rate policy has served Tunisia well in preserving external competitiveness and protecting the viability of the external balance. The real exchange rate target that has guided exchange rate policy until now should be expanded to take into account a broader set of indicators, such as developments in relative market shares and unit labor costs.

73. Successful disinflation has taken place against a background of sectoral (but synchronous) wage agreements, covering three-year periods. Despite the backward looking nature of these agreements, inflation has been reduced thanks to steady productivity growth and lower import prices. The main, and very considerable, advantage of the present system has been the high degree of social stability it has generated. Under this system, however, low inflation can only be maintained by ensuring that social partners agree to moderate wage increases. The fact that employers can count on the exchange rate policy to accommodate any excessive wage settlement undermines somewhat the incentives toward wage moderation, and will require that the government continue to intervene in the wage-setting process.

74. A preferable model would be for forward-looking wage agreements to be guided by a well-defined official inflation objective. Indeed, as the economy moves toward a more decentralized price setting process, inflationary expectations will need to be anchored more firmly on a clearly stated inflation target.

75. Because of limited capital mobility, monetary policy has retained a high degree of independence, even while pursuing a separate exchange rate objective. Prudent monetary

management, based on monetary and credit targeting, has contributed to the disinflation process. In the face of financial innovation and potential instability in the monetary aggregates, it would be advisable for monetary policy to expand the range of indicators used to gauge inflationary pressures, and eventually to use these to adjust the quantitative monetary objectives within target ranges.

76. The central bank's overall credit growth objectives appear to be pursued not only through the interest rate policy, but also in part through moral suasion. The staff recognizes that the situation derives in part from shortcomings in the degree of sophistication of the banking system and from the virtual absence of a money market. Still, it encourages the authorities to allow the interest rate to play a more active role in credit allocation. The development of the treasury-bill market will be an important step in this direction, and would be helped by opening the primary market to a wider number of participants.

77. Tunisia's sound fundamentals and its limited exposure to short-term capital movements have both been crucial in shielding the economy from the international financial turmoil that hit emerging market economies. In this regard, the authorities' decision, in 1998, to allow foreign exchange reserves to decline in the face of hardening borrowing conditions abroad was appropriate. Still, it increased the external vulnerability of the economy. The staff recommends that the marked improvement in borrowing conditions—as witnessed with the Eurobond issue of July 1999—be used to restore a more adequate level of reserves not only in terms of imports, but also as a ratio to short-term external debt.

78. In addition to a stable macroeconomic environment, growth will require that private sector initiative be given a much greater leeway in the economy. Until now, the state has intervened heavily in matters of resource allocation. To be sure, Tunisia benefits from solid physical and social infrastructures, but the fragility of the banking sector attests to the cost of past government intervention. Looking ahead, the state has an important role to play in the strengthening of institutions, skills and competence, as the successful experience with the industrial restructuring (*mise à niveau)* program demonstrates. However, there is no convincing rationale for preserving state monopolies or direct government intervention in productive activities such as banking, telecommunications, and transport and the social costs of disengagement from these activities should not be overstated.

79. The efforts to improve the transparency of the privatization process are most welcome, and the staff hopes that this will permit a marked acceleration of privatization, and of demonopolization. Stronger foreign participation in sectors other than energy would offer a number of additional advantages in terms of transfer of skills and technology, as well as an easing of the external financing constraint.

80. Much progress has been made to put the banking system on a sounder footing. The volume of nonperforming loans to the private sector remains nonetheless quite large. Vigilant supervision, as well as reforms aimed at improving the credit culture and encouraging loan recovery, need to be pursued vigorously. More generally, however, it is through privatization and foreign partnership that the financial viability of the banking sector will be fully restored, inasmuch

as this will strengthen the risk management capabilities of banks and enhance incentives to act prudently and in accordance to commercial principles.

81. Effective January 6, 1993, Tunisia accepted the obligations of Article VIII and its exchange system is currently free of restrictions on the making of payments and transfers for current international transactions, except for certain restrictions imposed pursuant to UN Security Council resolutions (see Appendix I for details), and the maintenance of a multiple currency practice resulting from honoring exchange rate guarantees extended prior to August 1988 to development banks. The government is not seeking, and the staff is not recommending, approval of this multiple currency practice, which will automatically expire after the existing commitments have matured in 2000.

82. The staff is encouraged by the authorities' broad-based efforts to increase the transparency of policies, including with the publication of this report, participation in the IMF's pilot project on the transparency of economic policies, and the authorities' intention to subscribe to the IMF's SDDS.

83. Available economic and financial data have generally been provided to the Fund on a regular and timely basis; most of those data are also published or made available to the wider public. However, there is scope for further improvements in the coverage and timeliness of economic data to enhance analysis and the basis for policy formulation.

84. It is proposed that the next Article IV consultation will take place within the standard 12-month cycle.

Table 1. Tunisia: Basic Economic and Financial Indicators, 1993–99

	1993	1994	1995	1996	1997	Est. 1998	Proj. 1999
	(Annual percentage change; unless otherwise indicated)						
Production and income							
Nominal GDP	7.0	7.8	7.9	11.8	9.6	8.7	10.1
Real GDP	2.2	3.3	2.4	7.0	5.4	5.0	6.5
GDP deflator	4.7	4.4	5.5	4.4	4.0	3.6	3.4
Consumer price index (CPI), average	4.0	4.7	6.3	3.8	3.7	3.1	3.1
Gross national savings (in percent of GDP)	19.8	20.1	20.2	22.4	23.4	24.1	25.1
Gross capital formation (in percent of GDP)	29.2	24.5	24.7	25.0	26.7	27.5	28.8
External sector (percent change)							
Exports of goods, f.o.b. (in US$)	-6.7	23.9	17.8	0.9	0.7	2.9	5.5
Imports of goods, f.o.b. (in US$)	-5.3	7.9	20.1	-2.4	3.2	4.8	6.6
Exports of goods, f.o.b. (volume)	4.0	18.3	3.0	-2.4	10.1	6.3	3.6
Import of goods, f.o.b. (volume)	6.7	-1.1	6.3	-2.5	8.7	5.2	8.3
Trade balance (in percent of GDP)	-13.8	-10.0	-11.0	-9.0	-10.3	-10.8	-11.0
Current account, excl. grants (in percent of GDP)	-8.8	-4.2	-4.3	-2.4	-3.1	-3.4	-3.7
Terms of trade (deterioration -)	0.2	-3.0	1.2	3.3	-3.6	-2.7	3.4
Real effective exchange rate (depreciation -) 1/	-3.7	0.8	2.2	0.7	-0.1	-0.1	0.8
	(In percent of GDP)						
Consolidated central government 2/							
Revenue, excluding grants	30.3	31.3	29.9	30.3	28.4	29.0	28.5
Total expenditure and net lending	34.5	33.8	34.5	35.5	32.6	31.8	31.1
Overall deficit, excluding grants and privatization	-4.2	-2.5	-4.5	-5.1	-4.2	-2.8	-2.6
Overall deficit, including grants	-3.8	-2.1	-4.2	-4.9	-3.8	-2.4	-2.3
Overall deficit, including grants and privatization	-3.8	-2.0	-4.1	-4.9	-3.8	-0.6	-2.3
Total government debt (foreign and domestic)	59.3	59.2	58.4	60.6	62.5	58.1	55.1
	(Change in percent; unless otherwise indicated)						
Money and credit							
Credit to the economy	9.5	7.7	10.1	14.5	9.7	7.8	7.6
Broad money (M2)	7.0	7.8	6.0	13.6	16.5	5.3	9.6
Velocity of circulation (GDP/M2)	2.3	2.3	2.4	2.3	2.2	2.2	2.3
Broader monetary aggregates (M4)	9.6	7.7	10.7	12.7	9.6	8.9	1.1
Velocity of circulation (GDP/M4)	1.7	1.7	1.6	1.6	1.6	1.6	1.8
Interest rate (money market rate, in percent)	10.5	8.8	8.8	8.6	6.9	6.9	5.9
Official reserves							
Gross official reserves (in billions of US$, end-period)	0.9	1.5	1.6	1.9	2.0	1.8	2.0
In months of imports of goods, c.i.f.	1.8	2.6	2.5	3.1	3.1	2.6	2.7
Total external debt (medium and long term)							
External debt (in billions of US$)	7.7	8.8	9.8	9.9	9.6	9.7	9.6
External debt (in percent of GDP)	55.3	55.5	54.9	51.8	52.8	47.4	45.2
Debt service ratio 3/	22.9	20.7	20.9	21.4	19.4	19.2	19.1
Financial market indicators							
Stock market index	251	507	635	571	456	465	608 4/
Memorandum items:							
GDP at current prices (in billions of US$)	14.6	15.6	18.0	19.6	18.9	19.9	21.4
Exchange rate: dinar/US$ (average period)	1.00	1.01	0.95	0.97	1.11	1.14	...

Sources: Data provided by the Tunisian authorities; and Fund staff estimates and projections.

1/ Information Notice System. For 1999, 12-month increase through February.

2/ Includes the social security system.

3/ In percent of exports of goods and nonfactor services.

4/ July 27, 1999.

Table 2. Tunisia: Balance of Payments, 1994–99
(In millions of U.S. dollars)

	1994	1995	1996	1997	Prel. 1998	Proj. 1999
Current account	-654	-777	-479	-593	-675	-786
Trade balance	-1,567	-1,988	-1,761	-1,955	-2,150	-2,357
Exports, f.o.b.	4,643	5,469	5,519	5,559	5,722	6,038
Energy	437	462	578	503	367	385
Nonenergy	4,206	5,007	4,940	5,057	5,355	5,653
Imports, f.o.b.	-6,210	-7,458	-7,280	-7,514	-7,872	-8,395
Energy	-466	-541	-607	-597	-396	-495
Nonenergy	-5,744	-6,917	-6,673	-6,918	-7,476	-7,900
Services and transfers (net)	913	1,212	1,283	1,362	1,475	1,571
Nonfactor services (net)	1,245	1,396	1,563	1,528	1,552	1,640
Of which						
Receipts from tourism	1,302	1,399	1,452	1,415	1,503	1,588
Factor services and transfers (net)	-332	-184	-281	-166	-77	-68
Of which						
Workers' remittances	688	753	820	765	792	833
Interest on external debt	-516	-605	-661	-535	-542	-572
Capital account	1,218	928	838	711	600	971
Grants	103	46	46	95	82	94
Direct foreign investment (net)	442	283	261	355	697	414
Medium- and long-term loans	578	540	472	484	-174	504
Disbursement	1,491	1,577	1,506	1,481	856	1,584
Amortization	-913	-1,038	-1,034	-997	-1,030	-1,080
Short-term capital and other 1/	95	59	59	-222	-5	-41
Overall surplus or deficit(-)	564	151	359	118	-74	186
Official net foreign assets (increase -)	-564	-151	-359	-118	74	-186
Of which						
Use of IMF resources	0	-15	-47	-50	-50	-50
Other assets, net (increase-)	-564	-136	-312	-68	124	-136
Memorandum items:						
Current account balance (in percent of GDP)	-4.2	-4.3	-2.4	-3.1	-3.4	-3.7
Gross official reserves (in months of imports)	2.6	2.5	3.1	3.1	2.6	2.7
External medium and long-term debt (in billions of US$)	8.8	9.8	9.9	9.6	9.7	9.6
External medium and long-term debt (in percent of GDP)	55.5	54.9	51.8	52.8	47.4	45.2
External short-term debt (in billions of US$)	1.1	1.3	1.5	1.5	1.6	1.7
External short-term debt (in percent of GDP)	7.1	7.3	8.0	8.1	8.0	8.0
Debt-service ratio 2/	20.7	20.9	21.4	19.4	19.2	19.1
Export volumes 3/	18.3	3.0	-2.4	10.1	6.3	3.6
Of which						
Nonenergy exports	21.0	2.9	-3.6	12.9	7.0	4.0
Import volumes 3/	-1.1	6.3	-2.5	8.7	5.2	8.3
Of which						
Nonenergy imports	-2.2	6.2	-2.2	9.0	7.1	7.3

Sources: Tunisian authorities; and Fund staff estimates and projections.
1/ Includes changes in net foreign assets of commercial banks, and errors and omissions.
2/ As a percent of exports of goods and services; including IMF charges.
3/ Annual percentage change.

Table 3. Tunisia: Indicators of External Vulnerability, 1990–99
(In percent of GDP; unless otherwise indicated)

	1990	1991	1992	1993	1994	1995	1996	1997	Est. 1998	Proj. 1999
Balance of payments										
Exports (percent change, 12-month basis in US$)	20.0	5.5	8.2	-6.7	23.9	17.8	0.9	0.7	2.9	5.5
Imports (percent change, 12-month basis in US$)	25.5	-5.7	24.2	-5.3	7.9	20.1	-2.4	3.2	4.8	6.6
Exports of goods, f.o.b. (volume)	4.5	4.4	-1.6	4.0	18.3	3.0	-2.4	10.1	6.3	3.6
Imports of goods, f.o.b. (volume)	9.6	-7.9	13.1	6.7	-1.1	6.3	-2.5	8.7	5.2	8.3
Terms of trade (percent change, 12-month basis)	-0.4	-0.7	0.2	0.2	-3.0	1.2	3.3	-3.6	-2.7	3.4
Trade balance (in percent of GDP)	-13.6	-9.1	-13.3	-13.8	-10.0	-11.0	-9.0	-10.3	-10.8	-11.0
Current account balance (in percent of GDP)	-5.5	-4.4	-7.8	-8.8	-4.2	-4.3	-2.4	-3.1	-3.4	-3.7
Capital and financial account balance (in percent of GDP)	4.6	4.0	8.8	9.1	7.5	4.9	4.7	5.0	2.7	4.7
Of which										
Inward portfolio investment (debt securities)	0.2	0.1	0.1	0.1	0.1	0.2	0.1	0.0	0.1	0.1
Other investment (loans, trade credit)	0.9	2.0	0.9	2.3	3.7	3.0	2.4	2.6	-0.9	2.4
Inward foreign direct investment	1.6	1.3	3.7	4.5	3.4	1.8	1.4	1.9	3.3	2.0
Gross official reserves (in billions of US$)	0.8	0.8	0.9	0.9	1.5	1.6	1.9	2.0	1.8	2.0
Gross official reserves (in months of imports of goods, c.i.f.)	1.6	1.7	1.8	1.8	2.6	2.5	3.1	3.1	2.6	2.7
Central bank short-term foreign liabilities	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.1
Short-term foreign assets of the financial and corporate sectors 1/	0.6	0.6	0.5	0.5	0.5	0.4	0.6	0.6	0.7	...
Short-term foreign liabilities of the financial and corporate sectors 1/	0.5	0.5	0.7	0.7	0.8	0.9	1.2	1.2	1.2	...
External debt										
External debt (in billions of US$)	8.0	8.6	8.3	8.8	10.0	11.2	11.4	11.1	11.3	11.3
Of which										
Medium- and long-term public and publicly guaranteed debt	7.0	7.7	7.5	7.7	8.8	9.8	9.9	9.6	9.7	9.6
Total external debt (in percent of GDP)	62.3	61.5	57.6	62.8	62.5	62.2	59.8	60.9	55.4	53.2
Of which										
Medium- and long-term public and publicly guaranteed debt	54.4	55.1	51.7	55.3	55.5	54.9	51.8	52.8	47.4	45.2
Ratio of total short-term external debt to reserves (in percent) 2/	134.7	113.9	91.2	116.5	75.6	79.7	79.1	73.9	87.8	84.5
Ratio of total short-term external debt (including current amortization) to reserves (in percent) 2/	251.4	228.5	180.5	207.0	137.9	142.7	131.1	121.7	144.2	137.7

Table 3. Tunisia: Indicators of External Vulnerability, 1990–99
(In percent of GDP; unless otherwise indicated)

	1990	1991	1992	1993	1994	1995	1996	1997	Est. 1998	Proj. 1999
Debt service ratio	26.5	27.0	22.7	22.9	20.7	20.9	21.4	19.4	19.2	19.1
External interest payments	7.6	7.5	7.0	7.8	7.2	7.4	8.0	6.4	6.3	6.4
External amortization payments	18.9	19.5	15.7	15.2	13.5	13.5	13.5	13.0	12.9	12.7
Exchange rates										
Exchange rate (per US$, period average)	0.88	0.92	0.88	1.00	1.01	0.95	0.97	1.11	1.14	...
REER appreciation (+, 12-month basis)	...	2.17	2.04	-3.73	0.79	2.18	0.67	-0.10	-0.10	0.80 5/
Financial market indicators										
Stock market index (9/30/90 = 100)	128	171	199	251	507	635	571	456	465	608 6/
Foreign currency debt rating 3/	...	...	...	...	...	BBB-	BBB-	BBB-	BBB-	BBB-
Spread of benchmark bonds (basis points, end of period)	...	...	...	...	...	...	...	140-180 4/	470-530 7/	280 8/

Sources: Tunisian authorities; and Fund staff estimates.

1/ Excludes monetary authorities. Refers to financial assets and liabilities only. Trade credits flows have been in balance in the 1995-97 period.

2/ Short-term defined as one year and less.

3/ FITCH IBCA and S&P long-term foreign currency rating. Moody's long-term rating is Baa3.

4/ Reflects the spreads of the 10-year and 30-year Yankee bonds above US Treasury, respectively, at launch.

5/ Information Notice System. For 1999, 12-month increase through February.

6/ July 27, 1999.

7/ Estimates of Merril Lynch emerging markets research, as at October 1998.

8/ July 1999.

Table 4. Tunisia: Consolidated Central Government, 1994–99 1/

	1994	1995	1996	1997	Budget 1998	Est. 1998	Prel. Proj. 1999
			(In millions of Tunisian dinars)				
Total revenue	4,943	5,104	5,786	5,933	6,656	6,579	7,132
Tax revenue	3,961	4,263	4,776	5,224	5,882	5,884	6,447
Of which							
Income taxes	734	807	893	1,113	716	1,294	1,403
VAT	855	899	1,008	1,170	1,428	1,443	1,605
Trade taxes	771	815	782	736	716	751	752
Nontax revenue	982	841	1,010	709	774	695	685
Total expenditure and net lending	5,337	5,864	6,764	6,804	7,342	7,223	7,785
Total expenditure	5,196	5,739	6,675	6,618	7,393	7,115	7,818
Current expenditure	4,210	4,636	5,362	5,283	5,869	5,644	6,013
Wages and salaries 2/	1,609	1,776	1,969	2,320	2,305	2,533	2,729
Goods and services	347	357	465	399	373	415	373
Interest payments	587	684	825	720	843	692	804
Domestic	267	339	475	317	353	257	334
External	321	345	350	403	490	435	470
Transfers and subsidies 3/	1,666	1,820	2,103	1,843	2,299	2,004	2,043
Other expenditure (nonallocated)	0	0	0	0	49	0	65
Capital expenditure	987	1,103	1,313	1,335	1,523	1,471	1,805
Direct investment	666	746	902	955	988	1,408	1,707
Capital transfers and equity	321	357	411	381	536	63	98
Net lending	140	125	89	186	-50	108	-32
Overall deficit (excluding grants and privatization proceeds)	-393	-759	-978	-871	-686	-644	-653
Grants	64	45	42	66	76	89	66
Privatization proceeds	16	17	10	3	100	418	0
Overall deficit, including grants and privatization	-314	-698	-926	-803	-510	-136	-587
Financing	314	698	926	803	510	136	587
Foreign	218	490	526	492	345	4	459
Domestic	96	208	400	311	165	132	128
			(In percent of GDP)				
Revenue	31.3	29.9	30.3	28.4	28.9	29.0	28.5
Tax revenue (excluding social security)	20.8	20.5	19.8	20.2	20.5	21.0	20.8
Of which							
Income taxes	4.6	4.7	4.7	5.3	3.1	5.7	5.6
VAT	5.4	5.3	5.3	5.6	6.2	6.4	6.4
Trade taxes	4.9	4.8	4.1	3.5	3.1	3.3	3.0
Social security contributions	4.3	4.5	5.2	4.8	5.0	4.9	4.9
Nontax revenue	6.2	4.9	5.3	3.4	3.4	3.1	2.7
Expenditure and net lending	33.8	34.5	35.5	32.6	31.9	31.8	31.1
Current expenditure	26.6	27.3	28.1	25.3	25.5	24.8	24.0
Wage bill	10.2	10.4	10.3	11.1	10.0	11.1	10.9
Goods and services	2.2	2.1	2.4	1.9	1.6	1.8	1.5
Interest payments	3.7	4.0	4.3	3.4	3.7	3.0	3.2
Transfers and subsidies	10.5	10.7	11.0	8.8	10.0	8.8	8.2
Of which							
Social security benefits	4.2	4.4	5.0	4.5	5.0	4.7	4.8
CGC 4/	2.0	2.0	2.2	1.8	1.5	1.7	1.2
Other expenditure (nonallocated)	0.0	0.0	0.0	0.0	0.2	0.0	0.3
Capital expenditure	6.2	6.5	6.9	6.4	6.6	6.5	7.2
Net lending	0.9	0.7	0.5	0.9	-0.2	0.5	-0.1
Overall deficit (-) excluding grants and privatization	-2.5	-4.5	-5.1	-4.2	-3.0	-2.8	-2.6
Grants	0.4	0.3	0.2	0.3	0.3	0.4	0.3
Privatization proceeds (net)	0.1	0.1	0.1	0.0	0.4	1.8	0.0
Overall consolidated deficit (-) including grants and privatization	-2.0	-4.1	-4.9	-3.8	-2.2	-0.6	-2.3
Primary balance, excluding grants	1.2	-0.4	-0.8	-0.7	0.7	0.2	0.6

Sources: Tunisian authorities; and Fund staff estimates.

1/ Includes special funds, *fonds de concours*, and the social security system.

2/ Starting in 1997 outturn and projections include public entities (EPAs and EPICs), and diplomatic posts.

3/ Starting in 1997 outturn and projections exclude transfers to public entities (EPAs and EPICs), and diplomatic posts on account of wage bills.

4/ Includes outlays of food agencies on behalf of the consumer subsidy fund.

Table 5. Tunisia: Monetary Survey, 1994–99

	1994	1995	1996	1997	1998	Proj. 1999
	(In millions of dinars; end of period)					
Foreign assets (net)	885	843	1,138	1,511	1,353	1,618
Central bank	1,148	1,245	1,666	2,049	1,906	...
Deposit money banks	-263	-402	-528	-538	-552	...
Net domestic asset	6,361	6,893	7,623	8,669	9,358	10,105
Domestic credit	8,568	9,286	10,464	11,746	12,500	13,410
Credit to government (net)	562	473	371	670	556	556
Credit to the economy	8,007	8,813	10,093	11,076	11,944	12,854 4/
Other items (net)	-2,207	-2,393	-2,841	-3,077	-3,142	-3,305
Money and quasi-money (M2)	6,811	7,221	8,204	9,556	10,062	11,023
Long-term deposits	435	514	558	624	649	700
Broad money (M4) 1/	9,347	10,344	11,658	12,783	13,915	14,067
	(Annual rate of change in percent)					
Domestic bank credit	6.1	8.4	12.7	12.2	6.4	7.3
Credit to government (net)	-12.2	-15.9	-21.5	80.7	-17.0	0.0
Credit to the economy	7.7	10.1	14.5	9.7	7.8	7.6 4/
Money and quasi-money (M2)	7.8	6.0	13.6	16.5	5.3	9.6
Reserve money (M0)	7.2	9.4	35.8	8.1	-10.6	20.0
Broad money (M4) 1/	7.7	10.7	12.7	9.6	8.9	1.1
	(Changes in percent of initial stock of M2)					
Foreign assets (net)	5.1	-0.6	4.1	4.5	-1.7	2.5
Credit to government (net)	-1.2	-1.3	-1.4	3.6	-1.2	0.0
Credit to the economy	9.1	11.8	17.7	12.0	9.1	9.1
Other items (net)	4.5	2.7	6.2	2.9	0.7	-0.4
	(Annual rate of change in percent; unless otherwise stated)					
Memorandum items:						
Total credit to the economy 2/	7.5	21.3	15.2	8.2	8.8	7.8
Total domestic credit 3/	6.2	11.5	12.3	7.4	9.3	0.3
Velocity (GDP/M2)	2.32	2.36	2.32	2.19	2.26	2.27
Velocity (GDP/M4)	1.69	1.64	1.64	1.64	1.63	1.78
Multiplier (M2/M0)	4.47	4.33	3.62	3.91	4.60	4.20

Sources: Tunisian authorities; and Fund staff estimates and projections.

1/ M2 plus long-term deposits, liquid treasury bills *(bons du Trésor cessibles),* and short-term commercial paper *(billets de trésorerie).*

2/ Including short-term commercial paper.

3/ Including short-term commercial paper and liquid-treasury bills.

4/ Credit to the economy includes TD 383 million of nonperforming loans that the state will take over by the end of the year.

Table 7. Tunisia: Medium-Term Macroeconomic Scenario, 1996–2004

	1996	1997	1998	1999	Projections 2000	2001	2002	2003	2004
					(Percentage change)				
Real GDP growth	7.0	5.4	5.0	6.5	6.0	6.0	6.0	6.0	6.0
Consumer prices	3.8	3.7	3.1	3.1	3.0	3.0	3.0	3.0	3.0
					(In percent of GDP; unless otherwise indicated)				
Gross national savings	22.4	23.4	24.1	25.1	25.3	25.4	25.7	26.1	26.3
Consolidated central government 1/	2.4	3.4	4.5	4.7	5.4	5.9	6.2	6.6	6.8
Rest of the economy	20.0	20.0	19.6	20.4	20.0	19.5	19.5	19.5	19.5
Gross investment	25.0	26.7	27.5	28.8	29.1	29.3	29.5	29.9	29.9
Consolidated central government 1/	4.7	4.6	6.2	6.8	6.6	6.6	6.6	6.6	6.6
Rest of the economy	20.3	22.1	21.3	22.0	22.5	22.7	22.9	23.2	23.3
Savings-investment gap	-2.6	-3.3	-3.4	-3.7	-3.8	-3.9	-3.8	-3.8	-3.6
Central government	-2.3	-1.1	-1.7	-2.1	-1.2	-0.7	-0.4	-0.1	0.2
Rest of the economy	-0.3	-2.1	-1.7	-1.6	-2.6	-3.2	-3.4	-3.7	-3.8
External current account	-2.4	-3.1	-3.4	-3.7	-3.8	-3.9	-3.8	-3.8	-3.6
External debt	51.8	52.8	47.4	45.2	44.9	44.4	43.3	42.2	41.2
Debt service ratio	21.4	19.4	19.2	19.1	21.0	17.4	17.1	16.6	17.9
Nonenergy export volume	-3.6	12.9	7.0	4.0	5.7	6.2	6.5	6.8	6.8
Memorandum items:									
Overall budget deficit central government 2/	-5.9	-4.0	-1.5	-2.8	-2.5	-2.0	-1.5	-1.0	-0.5
Overall fiscal deficit consolidated 1/	-4.9	-3.8	-2.4	-2.3	-1.9	-1.5	-1.2	-0.9	-0.6
Total public debt 3/	60.6	62.5	58.1	55.1	52.6	49.5	46.3	43.0	39.7

Sources: Tunisian authorities; and Fund staff estimates and projections.

1/ Includes the social security system and grants but excludes privatization proceeds.

2/ Based on the authorities' definition. Nonconsolidated central government including grants and privatization proceeds.

3/ As of 2000, includes the net present cost of nonperforming loans of public enterprises.

Table 6. Tunisia: Commercial Banking System—Performance Indicators, 1993–98
(Excluding development banks)

	1993	1994	1995	1996	1997	Prel. 1998
Average return on assets						
Private banks	0.7	0.8	1.0	1.1	0.9	1.0
Public banks	0.5	0.6	0.7	0.7	0.7	0.8
All banks	0.6	0.7	0.8	0.9	0.8	0.9
Average return on equity						
Private banks	24.4	25.9	27.9	31.0	22.0	25.1
Public banks	17.9	11.9	12.3	12.8	14.0	16.6
All banks	20.3	15.5	16.8	17.9	17.3	20.3
Capital adequacy ratio 1/						
Private banks	...	8.5	10.5	9.4	6.8	8.7
Public banks	...	2.1	2.2	3.4	5.9	9.1
All banks	...	3.7	4.6	5.1	6.3	8.9
Share of problem loans as percent of total commitments 2/						
Private banks	19.4	17.9	18.2	17.0	19.4	19.4
Public banks	40.7	37.7	36.8	29.3	25.8	19.6
All banks	34.0	31.4	30.8	25.1	23.0	19.5
Provisions as percent of problem loans, all banks	24.5	29.5	32.0	46.7	50.4	59.8
Insufficiency of provisions as percent of total capital, all banks	...	76.4	63.3	45.5	29.7	8.2
Memorandum items:						
Total credit to the economy as percent of GDP	50.7	50.7	51.8	53.2	53.0	52.6
Problem loans as percent of GDP	23.9	22.2	22.1	16.8	15.6	13.3

Source: Banque Centrale de Tunisie.

1/ Risk weighted. Averages weighted by banks' capital (*fonds propres nets*).

2/ Total commitments include credits to clients plus other contingent items such as guarantees.

Table 8. Tunisia: Medium-Term Balance of Payments, 1996–2004
(In millions of U.S. dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Current account	-479	-593	-675	-786	-875	-989	-1,051	-1,119	-1,180
Trade balance	-1,761	-1,955	-2,150	-2,357	-1,978	-2,102	-2,265	-2,414	-2,565
Exports, f.o.b.	5,519	5,559	5,722	6,038	6,416	6,904	7,514	8,205	8,966
Energy	578	503	367	385	339	288	289	290	291
Nonenergy	4,940	5,057	5,355	5,653	6,078	6,616	7,225	7,915	8,675
Imports, f.o.b.	-7,280	-7,514	-7,872	-8,395	-8,395	-9,005	-9,779	-10,619	-11,531
Energy	-607	-597	-396	-495	-500	-544	-593	-645	-703
Nonenergy	-6,673	-6,918	-7,476	-7,900	-7,895	-8,461	-9,186	-9,973	-10,829
Services and transfers (net)	1,283	1,362	1,475	1,571	1,714	1,886	2,055	2,207	2,376
Nonfactor services (net)	1,563	1,528	1,552	1,640	1,783	1,945	2,127	2,299	2,486
Of which									
Receipts from tourism	1,452	1,415	1,503	1,588	1,730	1,893	2,066	2,234	2,416
Factor services and transfers (net)	-281	-166	-77	-68	-69	-59	-72	-92	-110
Of which									
Workers' remittances	820	765	792	833	887	944	997	1,044	1,093
Interest on external debt	-661	-535	-542	-572	-587	-622	-666	-709	-751
Capital account	838	711	600	971	1,267	1,189	1,258	1,350	1,420
Short-term capital and other 1/									
Grants	46	95	82	94	110	118	126	126	125
Direct foreign investment and portfolio flows (net)	261	355	697	414	532	480	515	550	584
Medium- and long-term loans	472	484	-174	504	625	591	617	675	711
Disbursement	1,506	1,481	856	1,584	2,002	1,728	1,860	1,998	2,348
Amortization	-1,034	-997	-1,030	-1,080	-1,377	-1,137	-1,243	-1,323	-1,637
Short-term capital and other 1/	58	-222	-5	-41	0	0	0	0	0
Overall surplus or deficit(-)	359	118	-74	186	392	200	208	231	240
Official net foreign assets (increase -)	-359	-118	74	-186	-392	-200	-208	-231	-240
Of which									
Use of IMF resources	-47	-50	-50	-50	-41	-28	-6	0	0
Other assets, net (increase-)	-313	-68	124	-136	-351	-172	-201	-231	-240
Memorandum items:									
Current account balance (in percent of GDP)	-2.4	-3.1	-3.4	-3.7	-3.8	-3.9	-3.8	-3.8	-3.6
Gross official reserves (in months of imports)	3.1	3.1	2.6	2.7	3.0	3.0	3.0	3.0	3.0
External medium- and long-term debt (in billions of US$)	9.9	9.6	9.7	9.6	10.4	11.1	11.8	12.6	13.4
External medium- and long-term debt (in percent of GDP)	51.8	52.8	47.4	45.2	44.9	44.4	43.3	42.2	41.2
External short-term debt (in billions of US$)	1.5	1.5	1.6	1.7	1.9	2.0	2.2	2.4	2.6
External short-term debt (in percent of GDP)	8.0	8.1	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Debt-service ratio 2/	21.4	19.4	19.2	19.1	21.0	17.4	17.1	16.6	17.9
Export volumes 3/	-2.4	10.1	6.3	3.6	3.8	4.1	6.0	6.3	6.4
Of which									
Nonenergy exports	-3.6	12.9	7.0	4.0	5.7	6.2	6.5	6.8	6.8
Import volumes 3/	-2.5	8.7	5.2	8.3	4.9	5.9	5.9	5.9	5.9
Of which									
Nonenergy imports	-2.2	9.0	7.1	7.3	5.6	5.7	5.7	5.7	5.7

Sources: Tunisian authorities; and Fund staff estimates and projections.
1/ Includes changes in net foreign assets of commercial banks, and errors and omissions.
2/ As a percent of exports of goods and nonfactor services; including IMF charges.
3/ Annual percentage change.

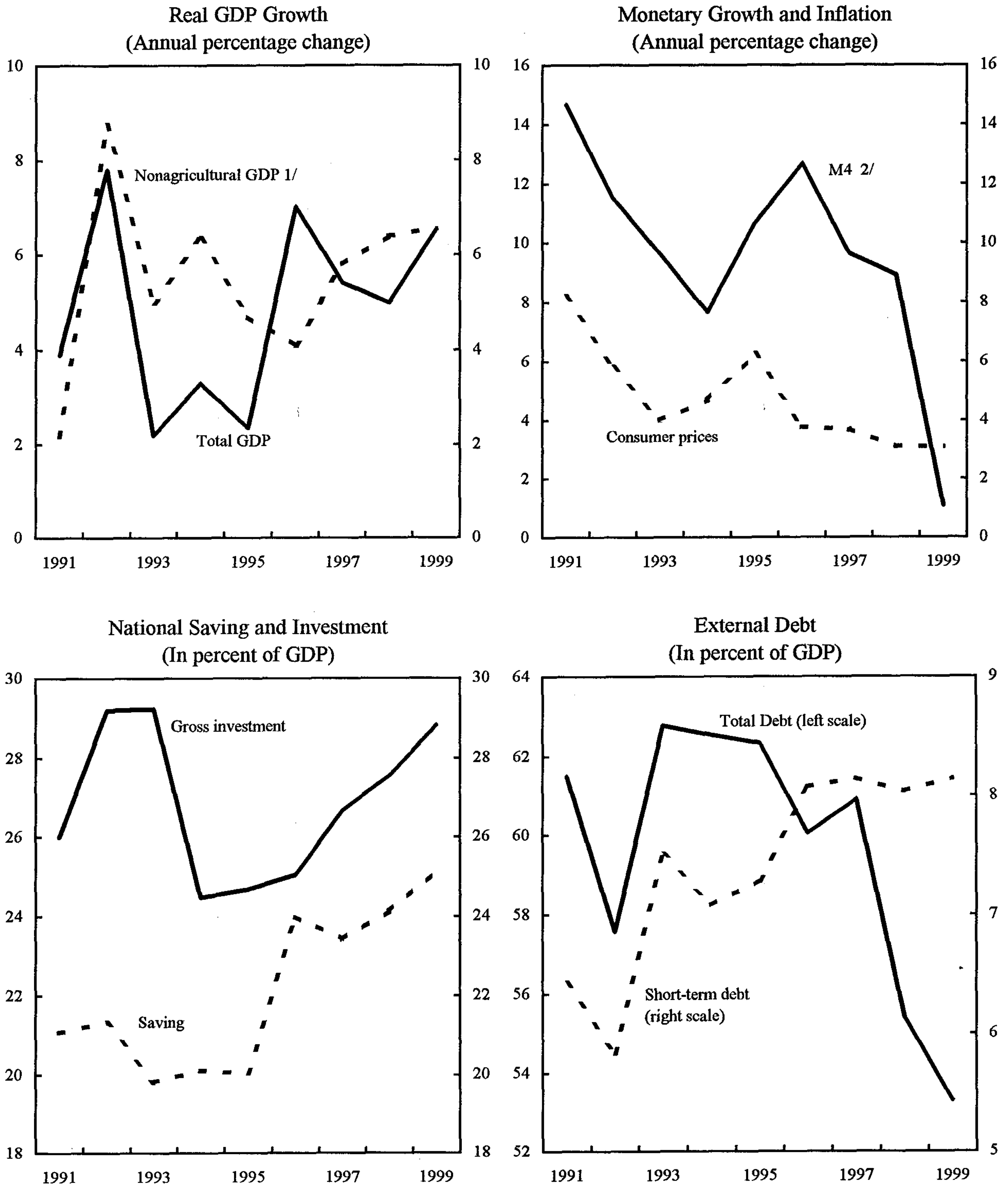
Table 9. Tunisia: Basic Social and Demographic Indicators, 1980–97

	1980	1985	1994 1/	1997	MENA countries 1/	All lower middle income countries 1/
Population characteristics						
Total population (in millions)	6.6 2/	7.3	8.8	9.2	272.4 8/	1,152.6 8/
Urban population (in percent of total population)	52	53	57	62	56	56
Birth rate (per thousand)	35 2/	31	24	19	32 8/	22 8/
Death rate (per thousand)	8 2/	7 6/	6	6	7 8/	8 8/
Life expectancy at birth (years)	62	66 6/	68	72	66 8/	67 8/
Population growth (in percent)	2.7	2.0	1.8	1.4	2.4 8/	1.3 8/
Income and wages						
GDP per capita (in 1990 dinars)	1,215 2/	1,273	1,451	1,602	...	...
GDP per capita (in current dinars)	631 2/	944	1,793	2,267	...	...
GDP per capita at current prices (in SDRs)	1,090 2/	1,115	1,238	1,490	1,407	1,193
Minimum wage in the nonagricultural sector (SMIG in current dinars per hour)	0.30 2/	0.46	0.70	0.82	...	...
Poverty incidence (headcount index, in percent of households)	11	7	7	29	...	...
Health						
Infant mortality (per thousand births)	71	55	40	39	...	...
Population per physician	3,694	2,162	1,763	...	4,235 9/	4,287 9/
Education						
Literacy rate (in percent)	46	58	68	...	63	...
Of which						
Female	...	47	59	...	50	...
Primary enrollment (gross, in percent of school age population)	103	116	118 7/	...	41 1/	103.8 10/
Secondary enrollment (gross, in percent of school age population)	27	39	52 7/	...	59 1/	63.6 10/
Pupils per teacher (primary school)	39	32	25 7/	...	26	...
Labor force						
Total labor force (in millions)	2.2	2.5 4/	3.2 3/	3.0	87.5	506.8 8/
Unemployment rate (in percent)	...	16.4 4/	15.3	...	...	...

Sources: World Bank; Ministry of Economic Development; and Fund staff estimates.

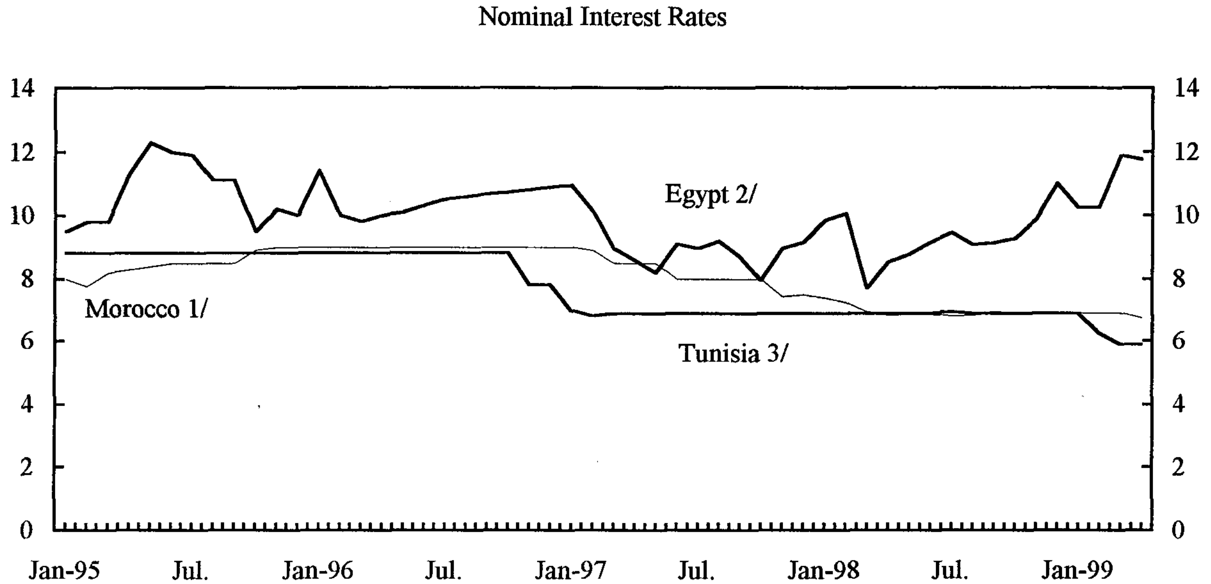
1/ Most recent estimates, 1989–94, unless otherwise indicated.
2/ Data for 1981.
3/ Data for 1996.
4/ Data for 1984.
5/ Data for 1989.
6/ Data for 1987.
7/ Data for 1993.
8/ Data for 1995.
9/ Data for 1981.
10/ Data for 1992.

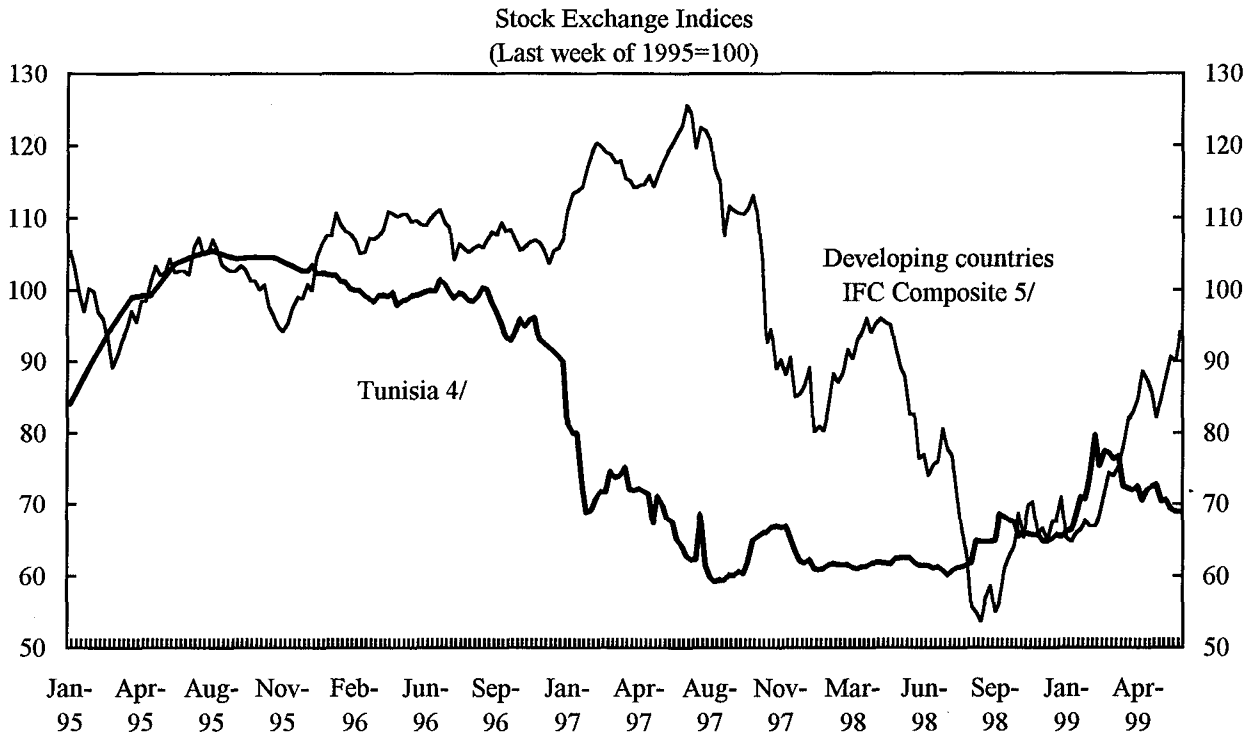
Chart 1. Tunisia: Main Economic Indicators, 1991–99



Sources: Data provided by the Tunisian authorities; and Fund staff estimates.
1/ Excludes also food processing.
2/ Broad money plus short-term liquid instruments (see Table 5).

Chart 2a. Comparative Financial Indicators, 1995–99

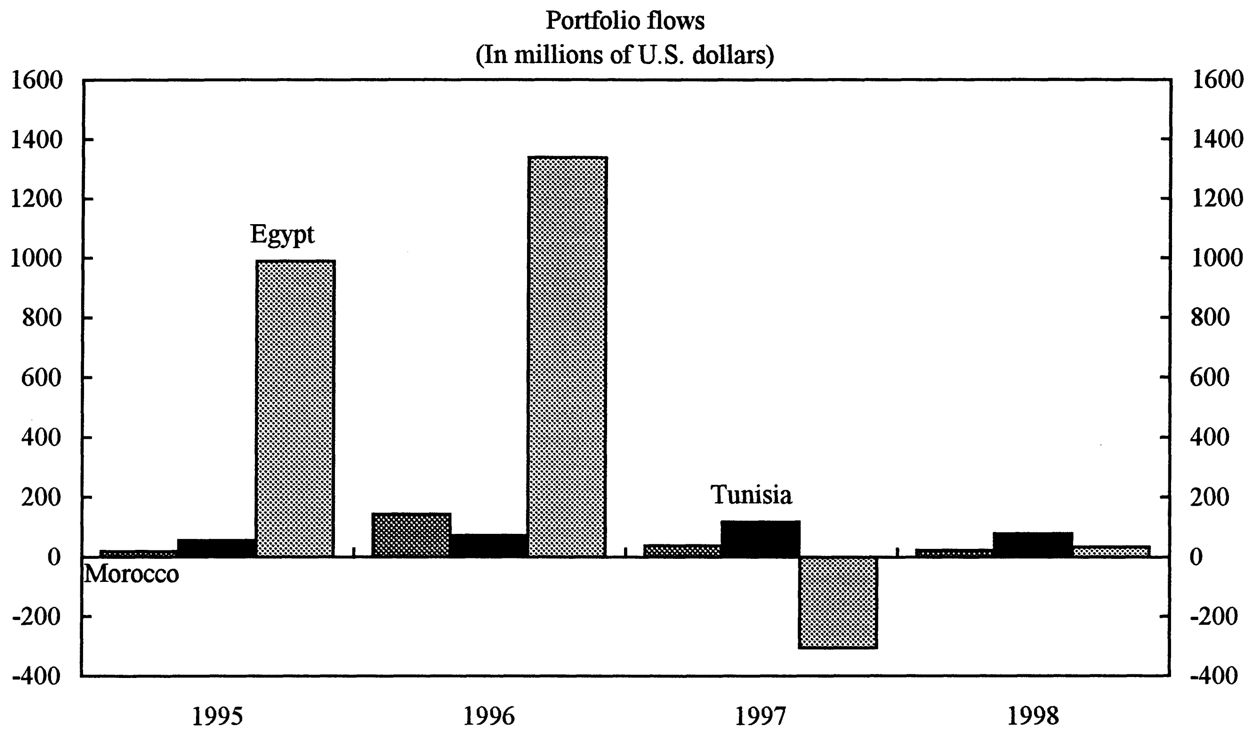




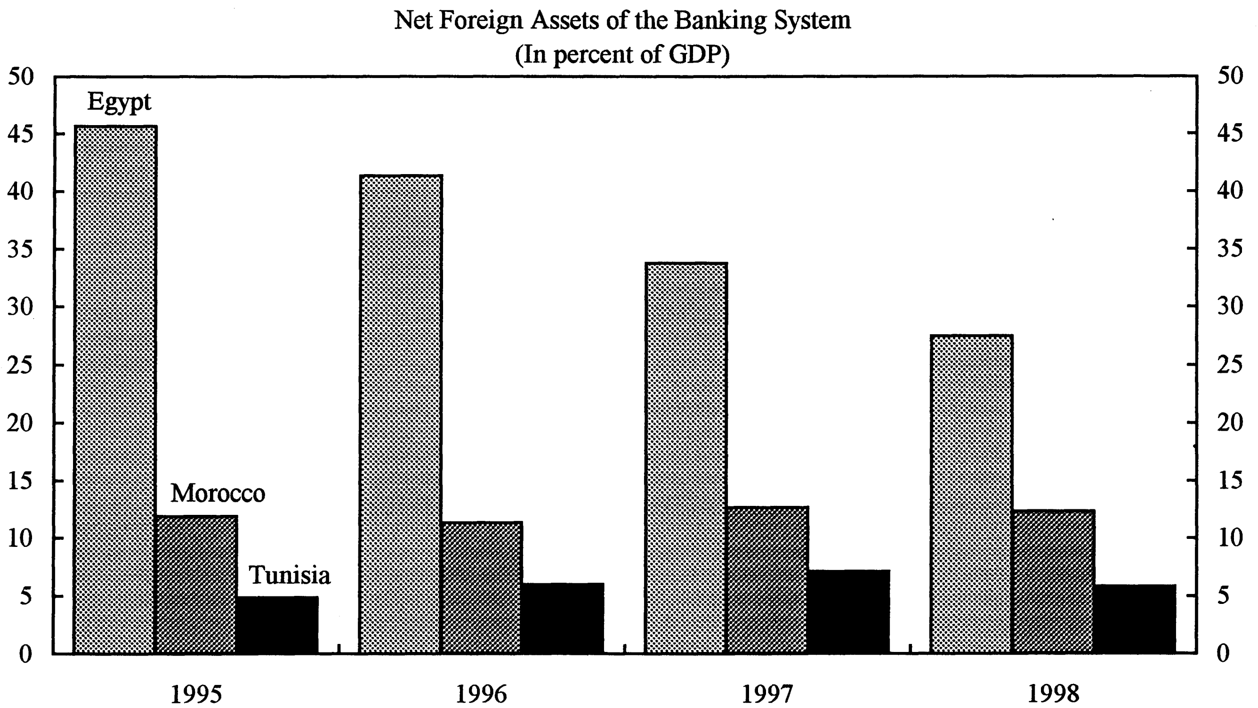
Source: IMF, Middle East Economic Digest (MEED); International Financial Statistics; and IFC database.
1/ 52-week T-Bill rate
2/ 1-week money market rate from Jan 1995 to Jul 1996, overnight money market rate from Jul 1996 on.
3/ Overnight money market rate.
4/ BVMT in U.S. dollar terms (MEED).
5/ Investible index data as reported by IFC.

Chart 2b: Comparative Financial Indicators, 1995–98

Portfolio flows
(In millions of U.S. dollars)

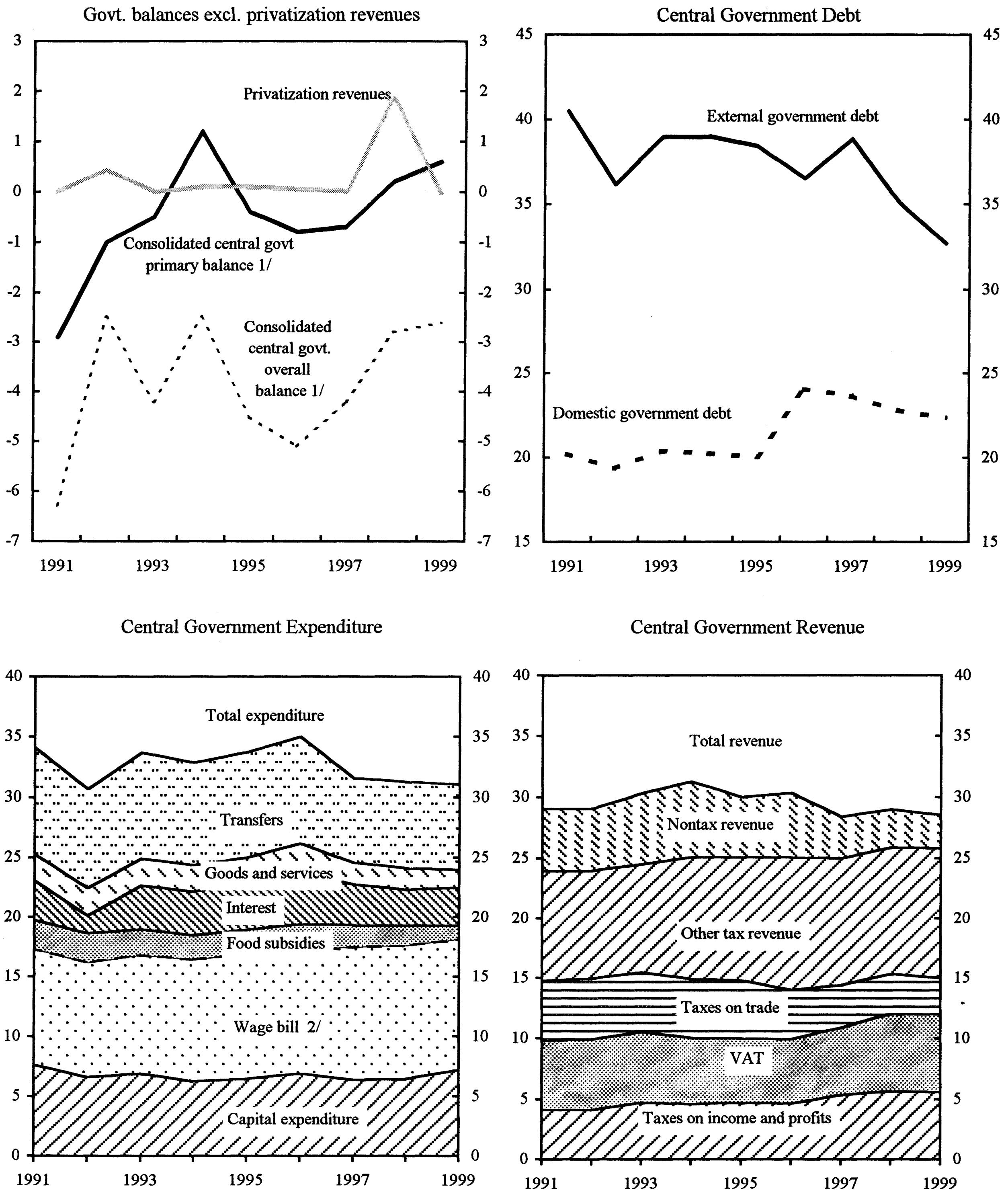


Net Foreign Assets of the Banking System
(In percent of GDP)



Sources: IMF, Middle East Economic Digest (MEED); International Financial Statistics; and IFC database.

Chart 3. Tunisia: Fiscal Developments, 1991–99
(In percent of GDP)

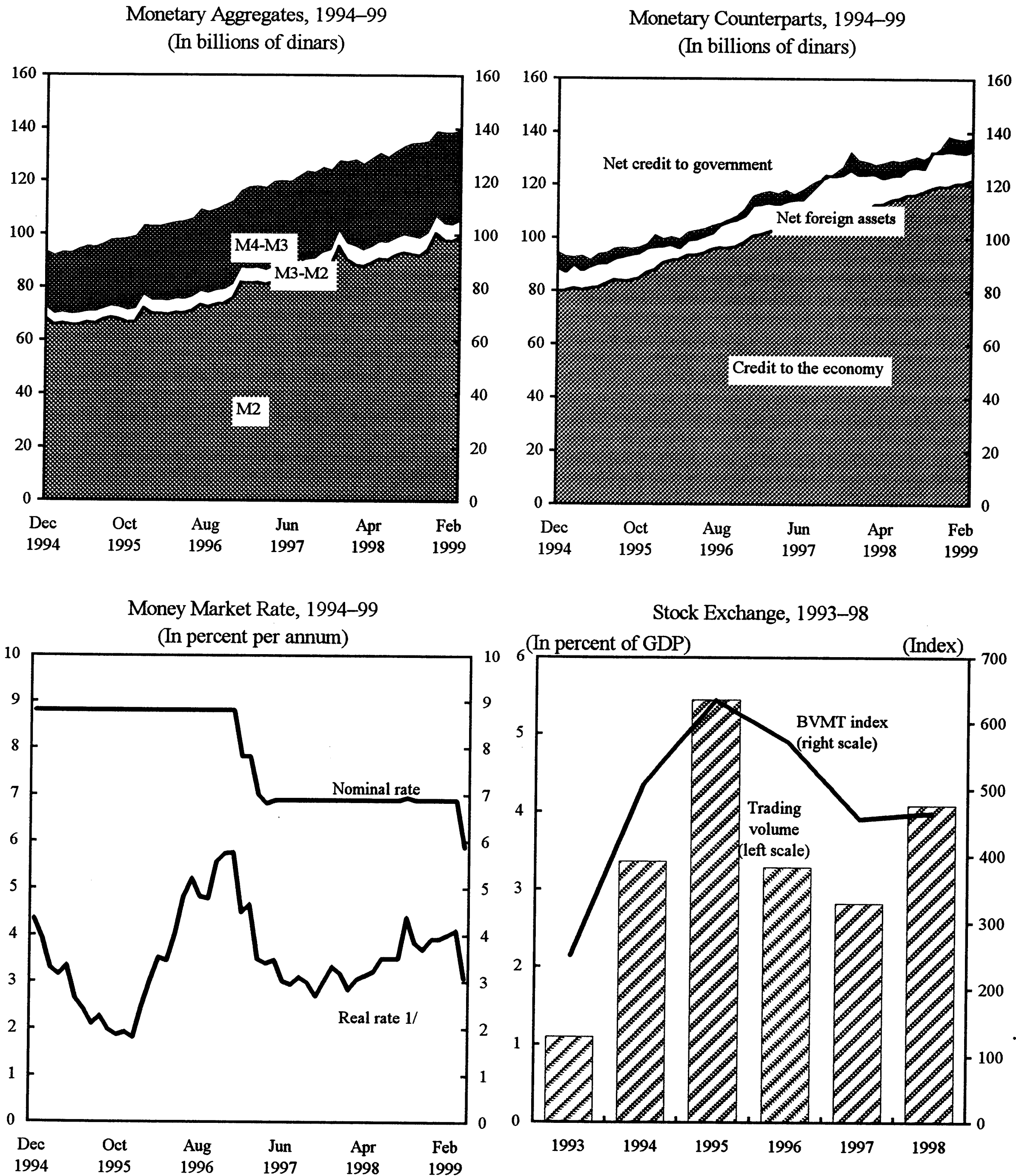


Sources: Data provided by the Tunisian authorities; and Fund staff estimates.

1/ Includes the social security, but excludes grants and privatization proceeds.

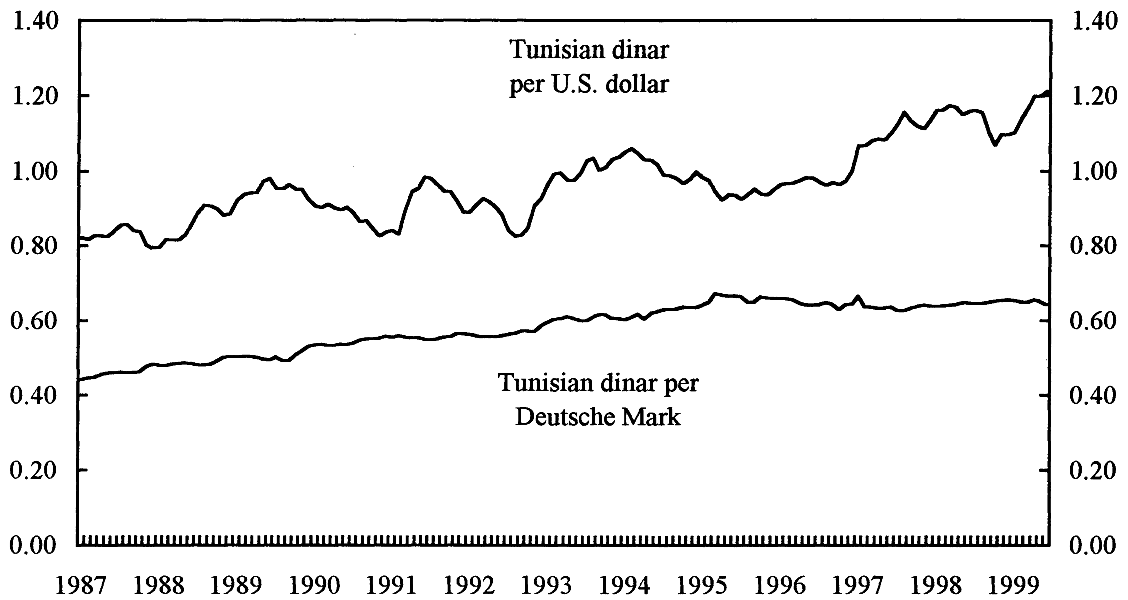
2/ Starting in 1997 includes transfers for wages of local government and embassies, previously recorded under transfers.

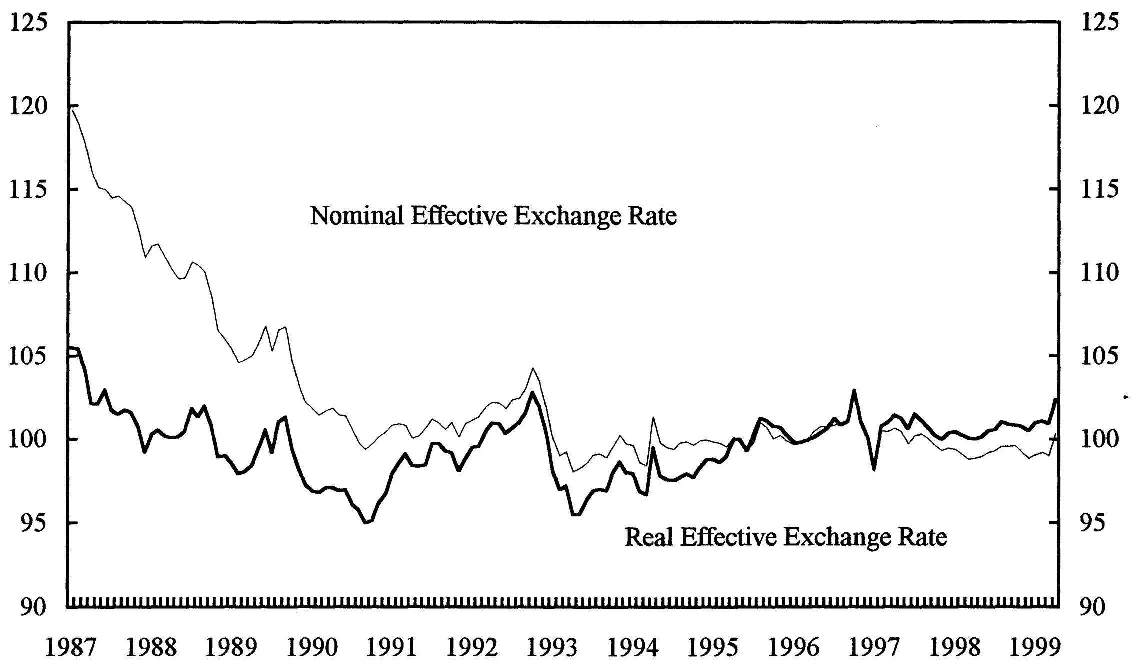
Chart 4. Tunisia: Monetary and Financial Indicators



Sources: Data provided by the Tunisian authorities; and Fund staff estimates.
1/ Based on CPI inflation over preceding 12 months.

Chart 5. Tunisia: Exchange Rate Indicators, 1987–99



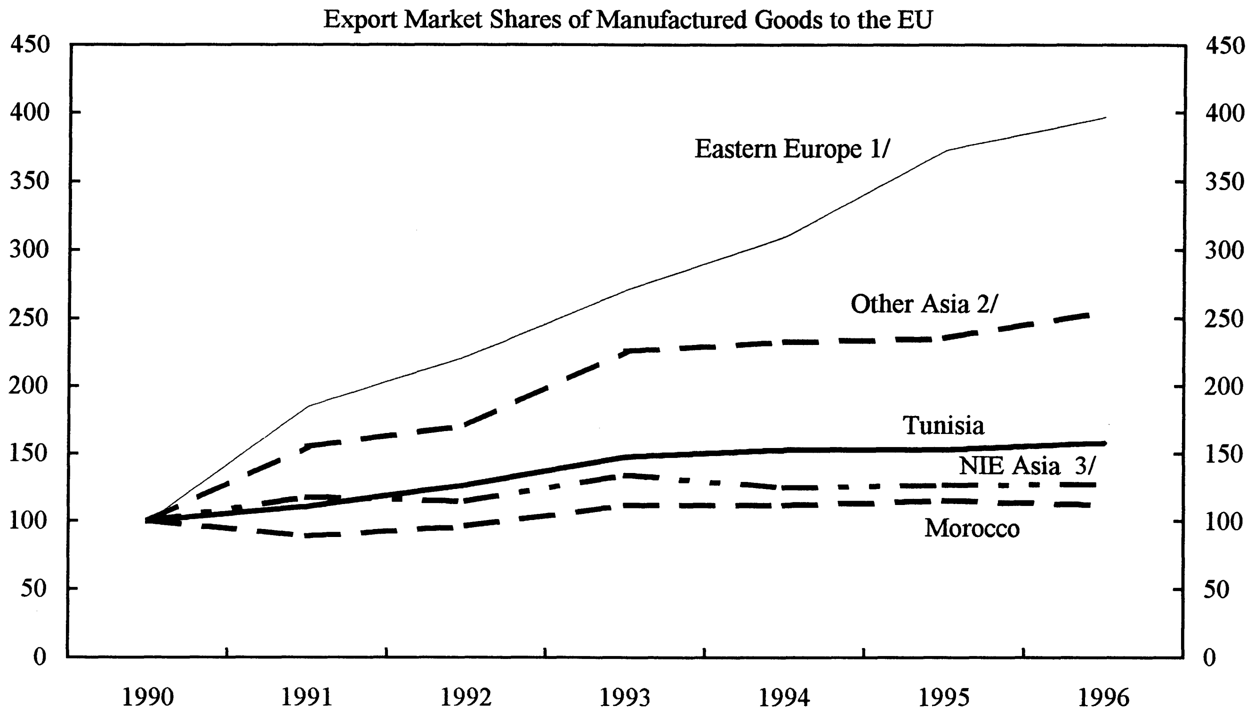


Sources: International Monetary Fund: Information Notice System, and International Financial statistics.

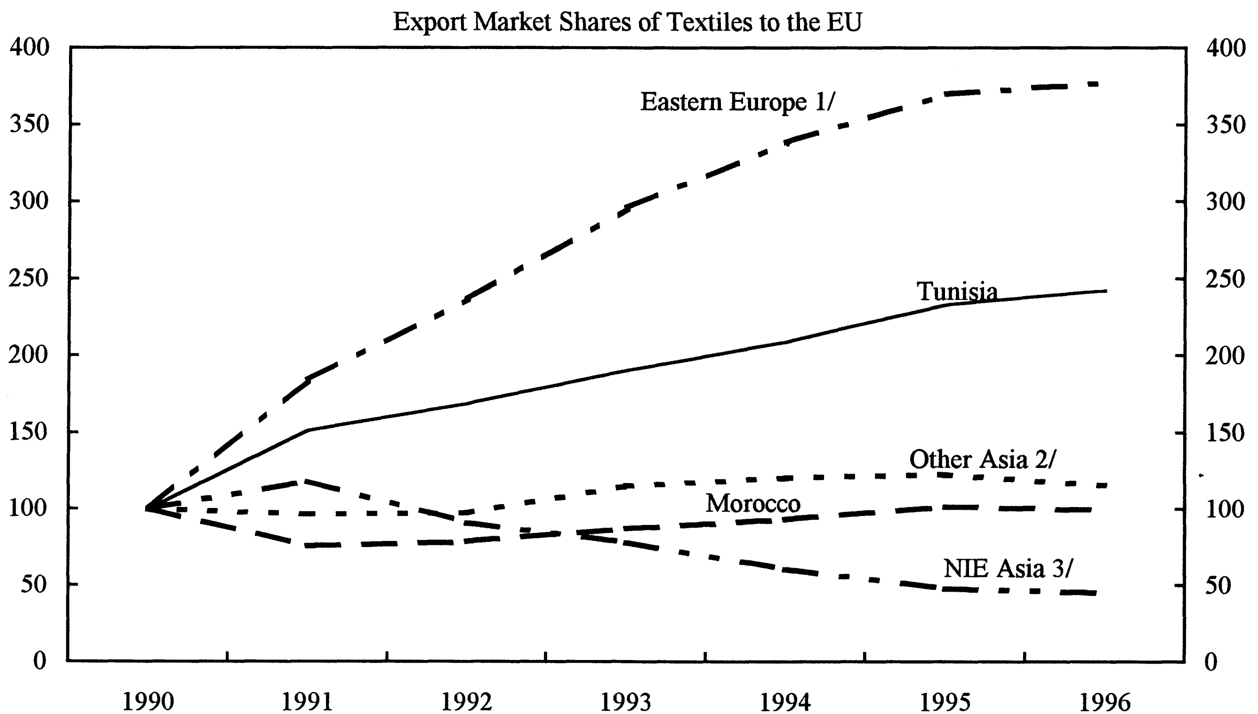
Chart 6. Tunisia: Export Market Shares

(Index; 1990 = 100)

Export Market Shares of Manufactured Goods to the EU



Export Market Shares of Textiles to the EU



Sources: United Nations, TARS; and Fund staff estimates.

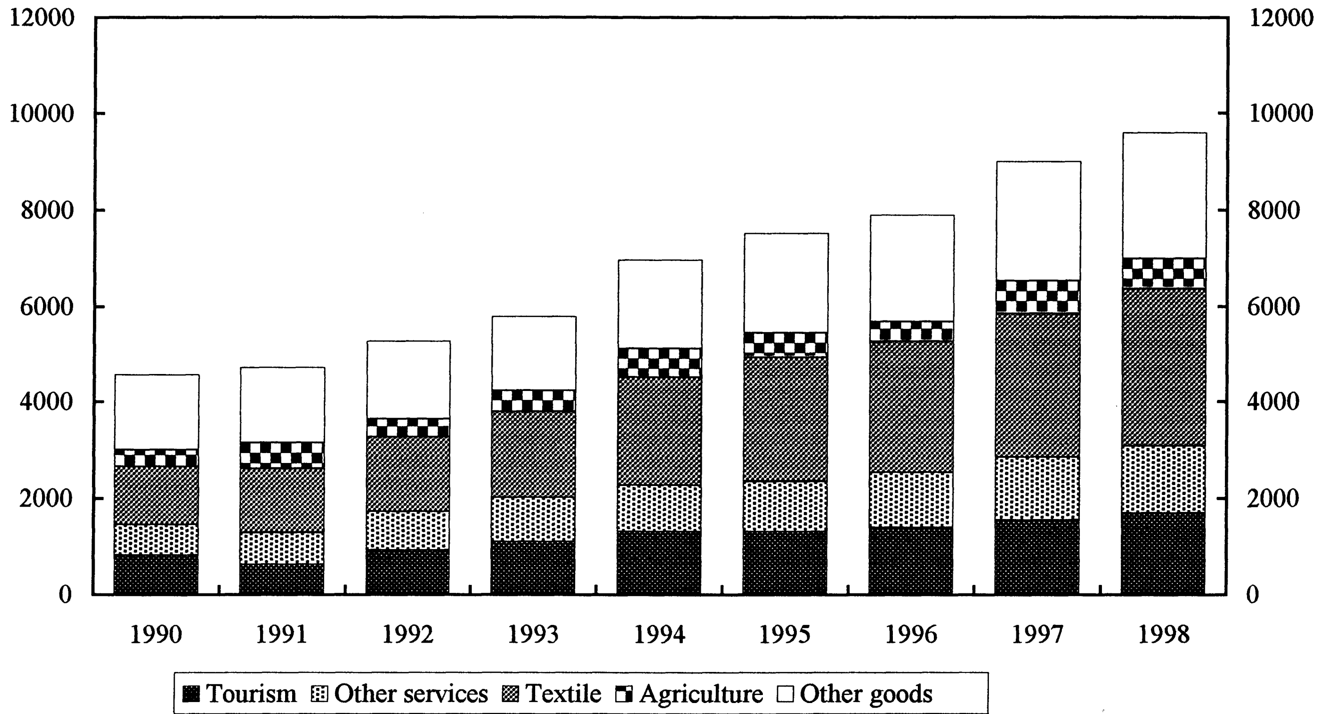
1/ Czech Republic, Slovak Republic, Bulgaria, Hungary, Poland, Romania.

2/ China, Malaysia, Thailand.

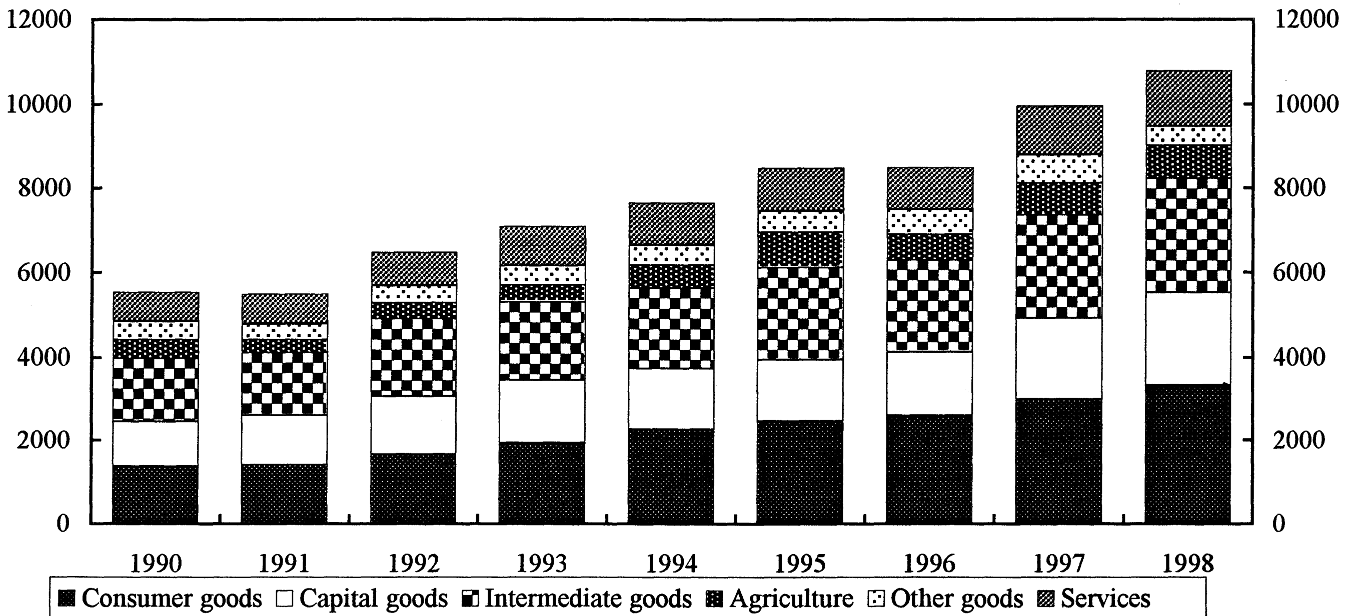
3/ Hong Kong, Korea, Singapore, Taiwan.

Chart 7. Tunisia: Composition of Trade, 1990–98
(In millions of dinars)

Composition of Exports of Goods and Nonfactor Services



Composition of Imports of Goods and Nonfactor Services



Source: Ministry of Economic Development.

Box 1. Medium-Term Policy Framework

Economic policies have been guided by medium-term development plans covering five-year spans. The IXth Economic Development Plan (1997–2001) set out as objectives to:

- raise growth to an average of 6 percent per year over the plan period,
- reduce unemployment from 15.5 percent to 14 percent by 2001,
- lower the inflation rate to 3.5 percent by 2001,
- reduce the external current account deficit to 2.2 percent by 2001,
- reduce (medium- and long-term) external debt to 43 percent of GDP, while maintaining foreign exchange reserves at a level equivalent to 3 months of imports.

The growth objective was predicated on a rise in the investment rate from 25 to 28 percent of GDP, coupled with a doubling of total factor productivity (TFP) growth to 2.4 percent per year on average over the period. The current account objective was to be achieved through a four-point rise in the saving rate (in percent of GDP).

The underlying policy targets included:

- an increase in government saving of more than 3 percent of GDP,
- a stabilization of the tax ratio at 20.3 percent of GDP, with compensatory measures making up for the prospective loss of trade tariff revenues (1.7 percent of GDP over the plan period),
- a reduction of government current expenditures by 4 percent of GDP,
- the pursuit of structural reforms with a view to raising productivity and private sector saving (privatization, liberalization, public enterprise reform, trade liberalization, labor market training and education, industrial restructuring, and financial sector reform).

Box 2. Reform of the Banking Sector

A program to restructure and strengthen the banking sector was launched in 1999 with the support of the World Bank, under a second Economic Competitiveness Adjustment Loan (ECAL II). The main objectives of the program are to tackle the chronic bad debt problem related to public enterprises, reform the public enterprises involved, strengthen the banking system's regulator framework and prudential regulations, and promote bank merger and privatization.

The settlement of nonperforming loans to public and semi-public enterprises: about 80 percent of TD 1.03 billion (5 percent of GDP) of nonperforming loans to public and semi-public enterprises are to be restructured or removed from bank balance sheets. The settlement involves 180 nonperforming loans to 49 public enterprises in more than 15 banks. Seventy percent of the loans to be settled are concentrated in three public sector banks, BNA, STB, and UIB. The amount to be settled will be close to TD 700 million after the exclusion of late interest charges and equity investments at a budgetary cost of TD 220 million in net present value terms. Banks will write off TD 74 million of fully provisioned late interest charges and will keep their remaining viable equity investments on balance sheets. The proposed settlement should reduce the loan provision shortfall in the banking system from TD 365 million to TD 165 million, allowing all but two banks to be in compliance with loan provisioning requirements.

Nonperforming loans to the private sector: in 1997, as a step toward the settlement of nonperforming loans to the private sector, which amounted to TD 4 billion, the government enacted a law for the creation of private debt resolution companies charged with the purchase and collection of bad loans to the private sector. Debt resolution companies have not been active until now partly because of unsettled tax issues regarding the treatment of capital losses and the reversal of loan provisions arising from the sale of nonperforming loans. Under the provisions of the ECAL II, the government proposes to introduce clear and fair tax measures that would promote the use of private debt resolution companies.

Regulatory framework and prudential regulations: efforts to avoid the recurrence of the problem include the raising of the capital adequacy ratio to the 8 percent by the end of 1999, from 5 percent presently. Two of the 13 commercial banks currently fall below the 5 percent ratio. The distinction between commercial banking and development banking will disappear with the introduction of a universal banking charter.

Bank merger and privatization: it is expected that in two years time only four banks will remain in the public sector. The main three will be: *Société Tunisienne de Banque (STB), Banque Nationale Agricole (BNA),* and *Banque de l'Habitat (BH).* STB is to merge with the *Banque Nationale de Développement Touristique (BNDT)*, which is currently 44.5 percent state-owned and which lends mainly to the tourism industry, and the *Banque de Développement Economique de Tunisie (BDET)*, a development bank which is 49.4 percent state-owned. The BNA will be kept within the public sector, in order to cater to the vital agricultural sector, and the BH will concentrate on the housing sector. The fourth state bank will be the one resulting from the merger of the *Union Internationale de Banque (UIB)*, a commercial bank in which the state controls 58 percent, and the development bank *Banque de Tunisie et des Emirats d'Investissement (BTEI)*, in which the state controls 50 percent.

Box 3. The Industrial Restructuring Program (*Mise à Niveau*)

With the signing of the Association Agreement with the European Union in 1995, the authorities launched a vast program of industrial modernization (*mise a niveau*) aimed at helping enterprises meet the competitive challenge of free trade with Europe. The program is directed at upgrading the capital stock but also organization methods and practices, as well as managerial skills.

The program targeted to restructure 2,000 enterprises by the end of 2001, out of 4,000 potential candidates. The program is voluntary and open to all private sector enterprises. It is managed by a *Comité de pilotage* (COPIL), attached to the Ministry of Industry and composed of 16 members representing the government, the employers' federation (UTICA), the banks, and the labor union (UGTT). Eligibility for financial assistance under the program is determined on the basis of an external diagnostic study, covering the company's financial situation, its upgrading needs, and its potential for growth. A grant for up to TD20,000 can be obtained toward such a diagnostic study, and qualifying enterprises can recover up to 70 percent of its cost.

Eligible enterprises can apply for grants to cover part of the cost of their restructuring or upgrading projects. Grants are channeled through the *Fonds de développement de la compétitivité* (FODEC). The grant element is 10 percent for bank-financed projects (the project must be approved by a bank before being filed), and 20 percent for self-financed projects. A higher grant element can be obtained for investments in human capital. A total of about TD 2.5 billion (US$2.3 billion) has been allocated to finance these projects over the 1996–2000 period: TD 1.5 billion for the strengthening of individual enterprises through modernization of equipment or skills, the remaining amount for industry-wide support activities.

The authorities intend to increase support in the years ahead to economy-wide restructuring, through: (1) a program for improving financial, accounting, and managerial skills of small-and medium-sized enterprises; (2) programs to address sectoral problems, such as certification in international markets; and (3) a program for the *mise à niveau* of the providers of services to the industrial sector, i.e. consulting, computing, marketing, accounting, and communication services.

Between March 1996 and March 1999, 462 restructuring plans were approved, 38 percent of which in the textile sector, 14 percent in leather and shoes, and 13 percent in agro-industry. Total grants distributed under the program amounted to TD 135 million, supporting total investment of TD 998 million. Of that amount, TD 138 million were directed toward "intangible" investments, mostly in human capital.

A recent survey of 202 enterprises revealed that, over three years, the participating enterprises generated a 19 percent increase in employment, a 32 percent increase in sales and a 46 percent in exports. The realization rate of the investments was 52 percent.

Box 4. Privatization

In the mid–1980s, the public sector represented 40 percent of total investment and accounted for about 30 percent of total value added and 33 percent of total official employment. Public enterprises were experiencing mounting losses and had accumulated a debt burden of approximately TD 3 billion, or 35 percent of GDP.

In 1987, with World Bank-support, the government undertook to reduce the weight of the public sector in commercial activities by restructuring and privatizing small-and medium-sized public enterprises, mainly in the textile, tourism, and construction sectors. The program was modest, leading to the privatization of 48 small-scale enterprises over 1987–94, generating about US$80 million in sales proceeds. By the end of the program there remained about 232 public enterprises or entities.

A second and more ambitious privatization program was launched in 1996, with the support of a World Bank Economic Competitiveness Adjustment Loan (ECAL), targeting 63 public enterprises for privatization or liquidation, with an estimated total net asset value of US$1.4 billion. Between 1995–97, 45 enterprises were privatized, but the enterprises involved were relatively small and sale proceeds amounted to only US$200 million. With the privatization of two cement companies in 1998, cumulative privatization revenue for 1995–98 almost tripled to US$570 million.

In the context of the settlement of nonperforming loans to 49 public enterprises, supported by the ECAL II of 1999, 24 enterprises are to be liquidated while 4 enterprises, deemed strategic (with a combined asset book value of TD168 million) will continue to operate as public enterprises. The program also envisages complete and partial divestitures of the government from the remaining 20 enterprises. This will mark the complete withdrawal of the public sector from the construction, housing, and electrical supply sectors.

In recent years, large public enterprises such as the national airline, Tunisair, and the insurance company (Star) have also sold shares on the Tunis stock exchange. Nine other public enterprises are scheduled to sell shares on the stock market over the next year. Still many large enterprises in the sectors considered strategic (banking, telecommunication, mining, agro-industrial, and maritime and air transport) remain outside the realm of the current privatization program. The share of public enterprises in GDP was estimated at 22.5 percent over the 1992–95 period, and is unlikely to have declined below 20 percent since then.

In addition to sales of public assets, the authorities are promoting private sector participation in infrastructure through BOO/ BOT (build-operate-own or -transfer) contracts. The first BOO contract was signed recently with an American-Japanese consortium for the construction and operation of a 470 megawatt power plant in Rades. Further private participation is being sought in the electricity sector, highway construction, and water treatment and waste disposal.

Box 5. The Association Agreement Between Tunisia and the European Union

In an effort to further deepen its economic and financial relations with Europe, in mid-1995 Tunisia concluded and Association Agreement with the EU. The Agreement provides for a far-reaching liberalization of trade relations, enhanced financial and technical cooperation, and close collaboration in many areas, including cultural and political matters.

The Agreement phases in **free trade in industrial goods over 12 years**. Under the previous trade and cooperation agreements, in effect since 1976, nearly all of Tunisia's industrial exports had free access to EU markets. The main exemption was for certain textiles, for which a voluntary export restrain was, however, rarely binding. Under the new Agreement, this preferential access is preserved and extended to textiles, while Tunisia dismantles, over 12 years, all tariff and nontariff barriers to industrial imports from the EU, subject to a number of safeguard provisions. Quantitative restrictions and tariffs on a large number of items—mainly equipment goods—were abolished immediately as the Agreement came into effect; for other categories of products, tariff reductions are to be fully eliminated by 2008 with a five-year grace period (on starting date of implementation) accorded to locally produced goods facing competitions from EU producers. Agricultural products are not covered by the Agreement, and tariffs on certain goods may be maintained in proportion to their agricultural content (the "agricultural element"). The Agreement provides that the EU and Tunisia will review the trade regime for agriculture in the year 2000. For specific agricultural products, the Agreement consolidates, and in some cases improves, the existing preferential mutual access.

The Agreement goes well beyond the existing framework of cooperation by calling for a **comprehensive harmonization of norms and standards and of the regulatory framework**, with a view to eliminating practices that distort trade between the partners, including monopolies, government subsidies, or privileges granted to public enterprises. Economic and financial cooperation is to be strengthened, particularly to support industries that will face difficulties in adjusting to free-trade agreement (*mise à niveau* program), promote intra-Maghreb regional integration, and enhance environmental protection. Financial support for Tunisia's adjustment and development efforts is provided from EU resources under the EU's Mediterranean Initiative.

The Agreement also **calls for active cooperation in social areas**, such as social development and immigration to Europe, and consolidates the existing rights and obligation of expatriate workers.

Impact of the Agreement

A study commissioned by Tunisia's Ministry of International Cooperation and Foreign Investment estimated that the Agreement would produce a long-term (static) gain of 1.4 percent of GDP (when all factors of production are reallocated) and larger gains if liberalization is extended to non-EU imports. In the short run—when labor, but not capital, could be reallocated—gains are estimated to be negligible.

The Agreement will have a significant **fiscal impact**, resulting from the elimination of import duties, which accounted for about a fifth of total tax revenue at the time of the Agreement was signed. The cost of foregone revenues is estimated to reach 3.5 percent of GDP by 2008. This loss may be partially offset by the revenue impact of faster economic growth. IMF technical assistance was provided in 1996 to identify compensatory tax measures, most of which have since been put in place, except for the proposed elimination of tax exemptions.

Box 6. The Instruments of Monetary Policy and the Money Market

The Central Bank of Tunisia (CBT) has the following instruments of control at its disposal:

- **Reserve requirements**: set at 2 percent, they have not been used as an instrument of monetary policy.
- **Weekly liquidity auctions** (*appel d'offres*): it is the main instrument of intervention. The bids for 7-day liquidity are all satisfied at the same official intervention interest rate, in proportion to the quantities demanded.
- **Weekly bids for liquidity** (*appel d'offres de reprise de liquidité*): they are used to mop up excess liquidity when the banking system as a whole is over liquid. Bids for the placement of liquidity over 7 days are ranked and satisfied according to the rate that is proposed; the rate cannot exceed that of the weekly liquidity auctions.
- **Seven-day reverse repurchase operations**: they are used to inject additional liquidity at the initiative of banks, at a premium rate over the official intervention rate (currently 100 b.p.).
- **End-of-day settlement operations**: they allow commercial banks, at their own initiative, to obtain or place liquidity at the official intervention rate, at the end of the day.

Liquidity is provided only against eligible collateral, essentially most performing loans, except consumer loans. The main shortcoming with this system is that the CBT has attempted through the weekly liquidity auctions to control both the volume and the price of credit. At the same time however, it has allowed banks automatic access to its end-of-day facility at the same interest rate. This practice has discouraged inter-bank transactions, and resulted in a rigid relationship between the intervention rate and the inter-bank rate.

In the context of the Article IV mission and the September 1998 technical assistance mission on monetary policy, IMF staff made the following main recommendations to improve monetary control and develop the money market:

- **Broadening the range of eligible collateral** for central bank refinancing to all performing loans as well as treasury paper, and rationing credit by the interest rate alone.
- **Refraining from injecting liquidity at the end of the day**, first by raising the interest rate on end-of-day operations, and then eventually phasing them out. This should push banks to meet their liquidity needs in the inter-bank market or through the more expensive 7-day repurchase operations.
- **Modifying the central bank law to allow the CBT to hold government paper of all maturities**, thus enabling it to accept government paper as collateral in its refinancing operations, and in time engage in open-market operations.

TUNISIA: FUND RELATIONS
(As of April 30, 1999)

Membership Status: Joined 4/14/58; Article VIII.

General Resources Account	**SDR million**	**% Quota**
Quota	286.50	100.0
Fund holdings of currency	339.81	118.6
Reserve position in Fund	20.17	7.0

SDR Department	**SDR million**	**%**
Allocation		
Net cumulative allocation	34.24	100.0
Holdings	24.07	70.3

Outstanding Purchases and Loans	**SDR million**	**% Quota**
Extended arrangements	73.47	25.6

Financial Arrangements

Type	Amount Approval Date	Amount Expiration Date	Approved (SDR Million)	Drawn (SDR Million)
EFF 7/25/1988	7/25/88	7/24/92	207.30	207.30
Stand-by	11/04/86	5/31/88	103.65	91.00

Projected Obligations to Fund (SDR Million; based on existing use of resources and present holdings of SDRs)

	Overdue	Forthcoming				
	06/30/1999	1999	2000	2001	2002	2003
Principal	0.0	18.3	30.4	20.2	4.5	
Charges/interest	0.0	2.5	2.2	1.0	0.4	0.4
Total	0.0	19.9	32.6	21.2	4.9	0.4

A. Exchange Rate Arrangement and Exchange System

Tunisia accepted the obligations of Article VIII Sections 2,3, and 4 effective January 6, 1993 and maintains an exchange system that is free of restrictions on the making of payments and transfers on current international transactions, except for certain restrictions relating to Iraq and the Federal Republic of Yugoslavia (Serbia and Montenegro), pursuant to UN Security Council Resolutions. These are subject to approval by the Fund in accordance with Decision 144-(52/51), but Tunisia has not yet notified the Fund in this regard. Tunisia also maintains a multiple currency practice resulting from honoring exchange rate guarantees extended prior to August 1988 to development banks, which will automatically expire after the existing commitments have matured.

The Central Bank of Tunisia sets daily official exchange rates for the dinar with a spread of one percent between them, in the context of its policy of broadly keeping constant the real effective exchange rate. Since March 1, 1994, the market rates are determined in an interbank foreign exchange market. On June 5, 1999, the interbank rate of the dinar vis-à-vis the U.S. dollar was US$1=TD 1.17, equivalent to SDR 1=TD 1.57.

Article IV Consultation

Tunisia is on the 12-month cycle. The last discussions of the Article IV consultation were held in Tunis during March 6–18, 1998. The consultation was concluded by the Executive Board on June 15, 1998.

Technical Assistance

September 12–16, 1994: MAE—strengthening of monetary programming and analysis.

October 4–21, 1994: FAD—review of tax system.

September 19–October 7, 1994 and December 5–14, 1994: MAE—expert in area of monetary programming.

January 31–February 14, 1996: FAD—assessment of revenue impact of Association Agreement with EU.

March 31–April 4, 1997: STA—introduction of new methodological guidelines according to fifth edition of *Balance of Payments Manual.*

September 9–12, 1998: MAE—monetary management and development of the money market.

May 10-21, 1999: STA—quarterly national accounts.

May 13-18, 1999: STA—SDDS.

Resident Representative: None.

TUNISIA: RELATIONS WITH THE WORLD BANK GROUP
(As of June 30, 1999)

Since 1962, the World Bank has committed to Tunisia 108 loans and 10 IDA credits amounting to US$4,132 million and US$75 million (net of cancellations), respectively.

As of April 30, 1999 the sector shares of the Bank Group commitments were as follows: agriculture (22 percent), industry and energy (5 percent), transport and infrastructure/water resources (18 percent), human resources (21 percent), financial sector (12 percent), and nonsector adjustment loans (43 percent).

Bank lending at first emphasized support for long-term investment in infrastructure and social industrial financing. From 1986 to 1991, Bank lending supported increasingly policy reforms at the sector and macroeconomic levels. These have included an Agricultural Sector Adjustment Loan (1986), an Industry and Trade Policy Adjustment Loan (1987), a Structural Adjustment Loan (1988), a Public Enterprise Restructuring Loan (1989), and an Economic and Financial Reforms Support Loan (EFRSL) (1991).

In July 1996 the Bank approved a first Economic Competitiveness Adjustment Loan (ECAL I) to upgrade the private sector in preparation for the Free Trade Agreement (FTA) signed with the EU in 1995. The policy measures include the following: (a) a sound macroeconomic and fiscal framework; (b) acceleration in the implementation of the FTA; (c) acceleration of the privatization program; (d) greater flexibility in the labor market; and (e) administrative and regulator reforms.

The second tranche of ECAL I was released in June 1998 following the removal of government's monopoly of port handling and the completion of the restructuring plans for the state-owned shipping and stevedoring companies.

A second ECAL (ECAL II) for US$159 million, was approved by the Executive Board on April 20, 1999, in support of a program of reforms in the financial sector to supplement on-going reforms in the real sector.

Project implementation has been generally satisfactory and, in a number of sectors, important policy changes and institutional improvements have been achieved, and autonomous agencies have been created or strengthened to ensure the efficient management of the related sector or subsector. The Bank will continue its lending program committed at around US$250 million per year. The projects under preparation support health, private sector development, agriculture and rural credit, environment, education, the management of water resources, infrastructure, and industrial financing.

TUNISIA: WORLD BANK LOANS AND DEBT SERVICE, 1994–99 (FISCAL YEARS)
(In millions of U.S. dollars)

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Commitments	267.5	272.8	98.7	241.5	222.0	194.0
Investment projects	267.5	272.8	23.7	241.5	222.0	35.0
Adjustment loans	0.0	0.0	75.0	0.0	0.0	159.0
Disbursements	169.2	209.3	141.6	202.8	132.7	121.0
Investment projects	93.9	127.2	140.5	165.3	100.3	41.5
Adjustment loans	75.3	82.1	1.1	37.5	32.4	79.5
Total debt service	275.3	327.2	323.4	283.1	277.5	340.0
Amortization	154.9	199.3	198.7	174.9	180.9	240.0
Interest and charges	120.4	127.9	124.7	108.2	96.6	100.0

Sources: World Bank, Integrated Controller's System and DRS data and World Bank lending program for 1999.

Statistical Issues

1. Available economic and financial data have generally been provided to the Fund on a regular and timely basis; most of those data are also published or made available to the wider public. However, there is scope for further improvements in the coverage and timeliness of economic data to enhance analysis and the basis for policy formulation. Tunisia has indicated its interest in subscribing to the SDDS and a STA mission assisted the authorities with issues related to SDDS subscription

Real Sector

2. IFS coverage of data on real sector developments is satisfactory and most data are reported in a timely manner. However, export and import price and volume indices are reported with a long lag, with the latest data reported referring to the fourth quarter of 1994. Comprehensive data on employment and unemployment was last collected in the context of the 1994 five-year census. With a shift to a bi-annual survey, limited data on employment and unemployment for 1997 have recently been made available. Regarding wages, other than data on minimum wages, data on total wage bill and its sectoral distribution are only available through 1994. In the context of subscription to SDDS, the technical assistance mission on SDDS that visited Tunis in May, recommended that the Tunisian authorities collect and report data on employment, unemployment, and wages on a more frequent basis. The technical assistance mission on quarterly national accounts statistics, concluded that with additional resources, the National Institute of Statistics would be able to produce estimates of the quarterly production-based GDP at current and constant prices (as required by SDDS) by the end of 1999. However, the mission recommended that the release of these estimates be postponed until the estimation of expenditure-based GDP at constant prices is sufficiently advanced to ensure that both sets of estimates are consistent.

Government Finance

3. Government finance data are collected by the staff at the time of the Article IV consultation mission. Regarding data for publication, GFS data were reported in August 1997 and data up to 1996 are published in the *Government Finance Statistics Yearbook* 1998. Data cover consolidated central government. Tunisia does not report monthly or quarterly data for publication in IFS, or provide this information as part of the core indicators for surveillance.

Balance of Payments

4. Balance of payments statistics are generally adequate for surveillance. Efforts have been made to collect data on short-term external debt.

Money and Banking

5. Money and banking statistics are adequate for surveillance.

TUNISIA: CORE STATISTICAL INDICATORS
As of June 30, 1999

	Exchange rate	International reserves	Reserve/ base money	Central bank balance sheet	Broad money	Interest Rate	Consumer price index	Exports/ Imports	Current account balance	Overall government balance	GDP/ GNP	External debt and debt service
Date of latest observation	6/05/99	4/30/99	4/30/99	4/30/99	4/30/99	4/30/99	May 1999	May 1999	1998	1998	1998	1998
Date received	6/07/99	6/17/99	6/17/99	6/17/99	6/17/99	6/17/99	July 1999	July 1999	June 99	June 99	July 1999	June 99
Frequency of data	D	M	M	M	M	W	M	A	A	A	A	A
Frequency of reporting	M	M	M/V	M/V	M/V	M/V	M/V	V	V	V	V	V
Source of data	Central Bank/ Internet	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Ministry of Econ. Dev.	Ministry of Econ. Dev.	Central Bank	Ministry of Econ. Dev.
Mode of Reporting	Cable	Fax	Fax	Fax	STA rpt.	STA rept./ Mission	STA rept./ Mission	STA Rept./ Mission	Mission	Fax/ Mission	Mission	Mission
Confidentiality	U	U	U	U	U	U	U	U	U	U	U	U
Frequency of Publication	D	M	M	M	M	M	M	M	Q	A	Q	Q

A= annually; D= daily; M= monthly; Q= quarterly; U= unrestricted; V= during mission; W= Weekly.

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

Public Information Notice (PIN) No. 99/
FOR IMMEDIATE RELEASE

IMF Concludes Article IV Consultation with Tunisia

On September 2, 1999, the Executive Board concluded the Article IV consultation with Tunisia.[1]

Background

Despite a contraction of agricultural production, GDP grew by 5 percent in 1998. Gross fixed capital formation (27.5 percent of GDP), notably in Tunisia's traditional and new export sectors, was the most dynamic component of aggregate demand. The external current account deficit widened only slightly to 3.4 percent of GDP owing to a commensurate increase in the saving rate. Growth of exports of goods and services slowed primarily due to a decline in sales of crude oil and food products. CPI inflation declined further in 1998 to 3.1 percent, despite the increase in VAT rates and substantial increases in the prices of public transport and utilities, and in administered prices. Despite the strong growth performance, the unemployment rate has remained roughly unchanged at 15.6 percent. However, official statistics include nonactive job seekers in the definition of labor force. Outside of this group, unemployment has been largely concentrated among unskilled workers and first-time job seekers.

The limited exposure of the economy to short-term capital flows helped Tunisia weather the turmoil in international capital markets. As other emerging market economies, however, Tunisia faced a marked hardening of borrowing conditions on international markets. In light of the significant volume of FDI inflows in 1998, linked to the privatization of two large cement

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

factories, the authorities postponed the planned issuance of Eurobonds. This still entailed a decline in reserves to 2.6 months of imports from 3.1 months at the end of 1997. As of end-1998, Tunisia had a sizeable but sustainable external debt amounting to US$11.3 billion (55 percent of GDP, as compared to 61 percent a year earlier). Public and publicly-guaranteed debt, mostly medium- and long-term, accounted for 80 percent of the total. Short-term debt (US$1.6 billion) was mostly contracted by the private sector, a quarter of it in the form of trade credits.

Tunisia's strong performance in 1998 and into 1999, especially by regional standards, has its roots in a prudent and well-balanced macroeconomic policy stance, aimed at continued fiscal consolidation and disinflation, backed by a solid record of investment in social and physical infrastructure. Structural reforms have been proceeding at a cautious but steady pace, but the state retains extensive control over economic activity.

Considerable progress was made in 1998 on the fiscal front. The consolidated central government deficit (excluding privatization and foreign grants) narrowed from 4.2 percent of GDP in 1997 to 2.8 percent in 1998 (below the 3 percent fiscal target) mainly owing to new tax measures and to a decline in interest payments. The level of privatization receipts (1.8 percent of GDP) made it possible to reduce domestic debt financing, even in the absence of new external financing. Monetary policy attained the objectives that had been set for 1998. The growth of the liquidity aggregate M4 leveled off below nominal GDP growth. The central bank refinancing interest rate, unchanged since March 1997, was lowered in February 1999.

Structural reforms proceeded on several fronts, largely as planned. Notable progress was made toward restoring banking stability under a restructuring program, developed with the support of the World Bank, the main features of which were the clean up of bad loans to public enterprises, the strengthening of the prudential framework, and banking restructuring through the prospective merger of government-owned state banks. Still, as of end of 1998, the remaining nonperforming loans (to the private sector) stood at 22 percent of GDP. The industrial restructuring (*mise à niveau)* program launched in 1996 to restructure private manufacturing enterprises yielded some positive results with total approved investment of around US$920 million generated over three years toward upgrading productive capacity and human capital. The volume of privatization witnessed a marked acceleration in 1998, with the sale of two large cement factories to foreign investors for a total of US$380. However, state-owned enterprises still accounted for around 20 percent of value added in 1998.

Social indicators remain outstanding by regional standards, notably in terms of education, gender gaps, health provision, and housing—some 80 percent of the population own their homes. Social concerns however remain notably as related to the unemployment rate and the large school dropout rate.

Executive Board Assessment

Executive Directors commended the authorities for Tunisia's steady and strong growth performance, achieved in a context of low inflation and external stability. Directors noted that the authorities' prudent and consistent macroeconomic policy management had been a key

factor in achieving this performance. They also underscored the positive role played by the medium-term orientation of policies, steady structural reforms, and enlightened social policies.

Directors endorsed the authorities' economic strategy aimed at strengthening the economy's integration with the European Union, and stressed the benefits of lowering trade barriers in terms of enhanced productivity, competitiveness, and higher potential growth. They encouraged the authorities to build on this strategy by further liberalizing trade. Directors noted that the economy's ability to innovate and compete would depend on its ability to attract foreign investment. In this regard, they were of the view that the authorities' strong macroeconomic policy management would play a central role in maintaining the momentum of growth, but that this had to be complemented by deeper structural reforms and further liberalization of the economy.

Directors observed that an active exchange rate policy had served the country well. They supported the continuation of this policy, but recommended that, in adjusting the nominal exchange rate, the authorities should consider a broader set of competitiveness indicators than simply relative consumer prices, particularly as domestic markets are opening to foreign competition.

While Directors considered Tunisia's external imbalance to be sustainable, particularly in light of its strong investment record, they cautioned the authorities against allowing the current account deficit to widen much further. To that end, Directors suggested that the authorities could use the present strength of the economy to tighten the fiscal stance somewhat by accelerating the fiscal consolidation path envisaged under the IXth Economic Development Plan. Directors took note of the fiscal actions taken by the authorities to offset the decline in trade tariff revenues. They considered that further durable fiscal adjustment efforts should focus on broadening the tax base, improving tax administration, and addressing the main source of rigidity in the budget, namely the wage bill.

Directors remarked that Tunisia's successful disinflation had relied on sound incomes and monetary policies. They took the view that, to be sustained, this performance needed to be anchored in a more clearly defined inflation objective, which could guide both wage negotiations and monetary policy. Directors also noted the need for monetary policy to adapt to financial innovation by broadening the range of indicators used to gauge inflationary pressures. Directors recommended that the authorities allow interest rates to play a more active role in monetary policy and credit allocation.

Directors commended the authorities for the steps taken to strengthen prudential regulations and banking supervision and to clean up the burden of nonperforming loans to public enterprises. They expressed concern, however, about the volume of bad loans to the private sector, and urged the authorities to monitor this situation closely. Directors believed that privatization of the banking sector would improve management and incentives to act prudently, and urged the authorities to move more rapidly in this direction.

Directors noted the significant strides made toward an open market economy. While recognizing the important role of the state in strengthening institutions, they urged the authorities to move more forcefully to reduce the role of the state in allocating resources. In

particular, they saw scope for moving faster on price liberalization and in the privatization of public enterprises so as to increase economic efficiency and promote job creation.

Directors welcomed the attention given by the authorities to social development and to investment in human capital, and noted its positive impact on social indicators, which are among the highest in the region.

Directors commended the authorities for steps taken to improve the transparency of their policies and to disseminate economic statistics. They observed that Tunisia's economic statistics were adequate for surveillance, but recommended further efforts to improve the labor market and government statistics as regards the consolidated accounts of general government and public enterprises. Directors welcomed the authorities' decision to subscribe to the SDDS by 2000 and the measures taken to meet those requirements. They also welcomed the authorities' intention to participate in the pilot project for the voluntary release of Article IV consultation reports.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Tunisia: Selected Economic Indicators

	1994	1995	1996	1997	1998
Real sector			In percent		
Real GDP	3.3	2.4	7.0	5.4	5.0
GDP deflator	4.4	5.5	4.4	4.0	3.6
Consumer price index (CPI, period average)	4.7	6.3	3.8	3.7	3.1
External sector			In millions of U.S. dollars [1/]		
Exports of goods, f.o.b.	4,643	5,469	5,519	5,559	5,722
Imports of goods, f.o.b.	6,210	7,458	7,280	7,514	7,872
Current account, excluding capital grants (in percent of GDP)	-4.2	-4.3	-2.4	-3.1	-3.4
Foreign direct investment, net [2/]	442	283	261	355	697
Capital account balance	1,218	928	838	711	600
Total reserves minus gold	1,462	1,605	1,898	1,978	1,850
External debt (in billions of US$)	8.8	9.8	9.9	9.6	9.7
Debt service ratio (in percent of exports of goods and nonfactor services)	20.7	20.9	21.4	19.4	19.2
Real effective exchange rate (in percent) (depreciation -)	0.8	2.1	0.4	-0.1	-0.2
Financial variables			In percent of GDP [1/]		
Fiscal balance [3/]	-2.5	-4.5	-5.1	-4.2	-2.8
Revenues	31.3	29.9	30.3	28.4	29.0
Expenditures	33.8	34.5	35.5	32.6	31.8
Gross saving	20.1	20.0	22.4	23.4	24.1
Gross domestic investment	24.5	24.7	25.0	26.7	27.5
Change in broad money (M4) (in percent)	7.7	10.7	12.7	9.6	8.9
Interest rate (money market rate, in percent)	8.8	8.8	8.6	6.9	6.9

Sources: Data provided by the Tunisia authorities; and Fund staff estimates.
1/ Unless otherwise noted.
2/ In 1994, includes large inflows related to the building of a transmediterranean pipeline (Gazoduc) and development of an offshore gasfield (Miskar).
3/ Overall deficit excluding grants and privatization.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 99/90
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September 17, 1999

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

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The limited exposure of the economy to short-term capital flows helped Tunisia weather the turmoil in international capital markets. As other emerging market economies, however, Tunisia faced a marked hardening of borrowing conditions on international markets. In light of the significant volume of FDI inflows in 1998, linked to the privatization of two large cement factories, the authorities postponed the planned issuance of Eurobonds. This still entailed a decline in reserves to 2.6 months of imports from 3.1 months at the end of 1997. As of end-1998, Tunisia had a sizeable but sustainable external debt amounting to US$11.3 billion

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