

## International Monetary Fund

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**Tunisia:** Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

December 3, 2014

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The following item is a Letter of Intent of the government of Tunisia, which describes the policies that Tunisia intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Tunisia, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

## Appendix. Letter of Intent

Tunis, December 3, 2014

Madame Christine Lagarde  
Managing Director  
International Monetary Fund  
700 19th Street, NW  
Washington, D.C. 20431  
USA

Madame Managing Director,

- 1.** The legislative and presidential elections—which were held free and fair—have successfully brought in the final phase of our political transition to democracy. This political transition was accompanied by the implementation of economic reforms that are incorporated in the medium-term vision developed by the government and supported by civil society and the majority of the political parties in the context of the national dialogue. This economic vision was presented in September 2014 during the international conference “Invest in Tunisia” and was hailed by private investors and our development partners, who reiterated their support and confirmed their confidence in Tunisia’s proposed new development model. It is also fully consistent with the economic program and reforms supported by the IMF, to which we are firmly committed.
- 2.** However, we are aware that the the post-electoral period will be subject to uncertainties related to the formation of a new government, while the Tunisian economy will continue to face significant challenges. In this regard, we remain convinced that the implementation of prudent macroeconomic policies and structural reforms should continue in order to preserve macroeconomic stability and promote stronger and more inclusive growth. This is particularly important because the economic recovery has yet to meet the expectations of the population and fiscal and external imbalances remain high.
- 3.** Performance under the IMF-supported program remains broadly satisfactory, given the constraints associated with the national and international context in this final stage of the transition. Performance at end-September 2014 was in line with the program, and the implementation of structural reforms is moving ahead, albeit at a slower pace than originally envisaged.

  - *Quantitative performance criteria and indicative targets* . The quantitative criteria at end-June 2014 and end-September 2014 for net international reserves (NIR), net domestic assets (NDA), and the central government primary balance (on a cash basis) have been met. We adhered to the continuous zero ceiling on accumulation of external arrears and the continuous indicator on non-accumulation of domestic arrears. The ceiling on current expenditure at end-September 2014 has been met. However, the floor on social spending has not been met, primarily because of programmed expenditures for vulnerable families were postponed to the fourth quarter of 2014.

- *Structural reforms.* Two of the seven structural benchmarks to be implemented by end-November 2014 were met (Table 2A). In particular, the final report of the financial audit of the Banque Nationale Agricole (BNA) was completed slightly behind schedule in November 2014, but the associated restructuring plan (end-November structural benchmark), which has already been presented to the Council of Ministers, will only be finalized in line with good international practices once the recapitalization modalities are defined. Regarding fiscal policy, the new proposed tax code was adopted by the government as planned and submitted to Parliament in October, but the tax reform plan – discussed at the National Tax Consultation in November 2014—will be approved by the government only in December. The Asset Management Company (AMC), was created under the 2014 supplemental budget with a capital of 150 million dinars (TND), but its creation will only be effective once the AMC law is adopted in April 2015. Also, the recruitment of banking supervisors will not be possible before 2015, following the organization of an external competitive process. With regards to the end-September benchmark on the implementation decrees of the new investment code, the code itself was withdrawn from the National Constituent Assembly, as discussed during the last review, in order to be simplified and replaced by May 2015.

4. In view of the macroeconomic policies implemented to achieve the program's main objectives and the progress in the structural reform agenda (Tables 1, 2a, and 2b), the government requests the completion of the fifth review of the program supported by the Stand-By Arrangement. The government agrees to the proposed modification of performance criteria for NIR, NDA, and the primary balance at end-December 2014, and the proposed new criteria for March 2015 as well as new indicative benchmarks, as described in the attached Memorandum of Economic and Financial Policies (MEFP, Table 1) and Technical Memorandum of Understanding (TMU). The government also requests a re-phasing of disbursements, with a tranche of SDR 71.625 million for the fifth review and the allocation of remaining amounts in two tranches: a disbursement of SDR 214.875 million to be made available on March 15, 2015 subject to completion of the sixth review, which will be based on end-December 2014 performance criteria; and a disbursement of SDR 143.25 million to be made available on May 15, 2015 subject to completion of the seventh review, on the basis of end-March 2015 performance criteria.

5. This Letter of Intent (LOI) is based on the previous LOI and MEFP dated August 14, 2014. The attached MEFP discusses the key components of the government's program and the measures planned by the Central Bank of Tunisia that we intend to implement during 2014 and 2015. We are determined to rigorously apply our program while mindful of the difficulties associated with the national, regional, and international environment.

6. We are confident that the policies described in the attached MEFP are appropriate to achieving the objectives of our economic program, which is designed to ensure short-term macroeconomic stability while laying the foundation needed to support growth and protect vulnerable groups. We will remain vigilant, and we stand ready to take any additional measures that may be necessary to achieve these objectives. We will consult with IMF staff on the adoption of such measures and prior to any revision of the macroeconomic policies described in the MEFP, in accordance with IMF's policies on such consultations. All information and data required for program monitoring will be provided to IMF staff.

7. We authorize the IMF staff to publish this Letter of Intent and the attachments (MEFP, Tables 1, 2a, 2b, and 3, and the accompanying IMF staff report).

Sincerely yours,

/s/  
Chedly Ayari  
Governor, Central Bank of Tunisia

/s/  
Hakim Ben Hammouda  
Minister of Economy and Finance

## Attachment I: Memorandum of Economic and Financial Policies

### Recent Developments and Macroeconomic Outlook

- 1. Economic activity grew at a moderate rate, albeit slower than anticipated.** The recovery of services and a good cereal harvest could not offset lower oil and gas production, due to technical stoppages and a structural decline in reserves of production wells. As a result, the growth rate for the first six months of the year stood at 2.1 percent compared to 2.7 percent in our initial projections. For the rest of the year, a buoyant construction and public works sector and the acceleration of manufacturing industries (expected following the sharp increase in imports of intermediate products and capital goods) will allow the growth rate to increase to 2.4 percent for 2014. The growth rate will accelerate to 3 percent in 2015, as investors' wait-and-see attitude will diminish following the formation of the new government and the announcement of its program. Short-term risks remain significant, particularly in the event of renewed security tensions, delays in the formation of a new government after the elections, additional delays in reform implementation, or a deterioration in the economic outlook of our main partners in Europe.
- 2. Inflation remains contained.** Increased food prices, particularly for fresh foods, and electricity tariffs pushed inflation (year on year) from 5 percent in March 2014 to 6 percent in July 2014 before decreasing to 5.4 percent in October 2014. Core inflation remains controlled but edged higher to 5.0 percent in October 2014 (compared to 4.3 percent at end-June 2014) following a rise in the prices of services. Inflation is projected at 5.5 percent for the end of the year, reflecting a slowdown in food and energy prices, favorable base effects, measures aimed at controlling and monitoring distribution channels, and monetary policy tightening.
- 3. The current account deficit continues to widen, but this trend could reverse during the fourth quarter of 2014.** The deterioration of the current account deficit continues, reaching 7.1 percent of GDP at end-September. This continued underperformance is explained by a worsened trade balance, primarily the energy deficit associated mainly with the decline of national oil production and decreased volumes of gas transiting through the Algeria-Italy gas pipeline; these effects could not be offset by the slightly better than expected tourist flows and workers' remittances. For the rest of the year, lower commodity prices (food and energy), decreased volumes of food imports thanks to record domestic cereal and olive oil production, a more flexible exchange rate, and active promotion of our exports will help reverse this trend and contain the 2014 current account deficit at 7.9 percent of GDP. The deficit continues to be financed primarily by short-term flows, given that foreign direct investment has remained at 2013 levels. Disbursements of multilateral loans and a significant reduction in the Central Bank of Tunisia's (BCT) interventions on the exchange market increased gross reserves at end-September to \$7.7 billion and will bring them to \$7.8 billion at end-2014 (3.4 months of imports), below the program forecasts because of weaker than anticipated external budget support in the last quarter of 2014.

## Performance Under the Program and Strategy

**4. We are determined to rigorously implement our economic program in order to preserve short-term macroeconomic stability and lay the foundations for more sustained and inclusive growth.** The objectives of our program remain unchanged, and in this review we are focused on the following areas:

- **Maintaining macroeconomic stability.** Mobilizing tax revenue, containing the wage bill and subsidies, and tightening monetary policy in conjunction with a more flexible exchange rate, combined with placing limits on interventions in the foreign exchange market, are needed to maintain macroeconomic stability.
- **Laying the foundation for inclusive growth.** Swiftly finalizing the bank restructuring plans and reducing the vulnerabilities of public banks, improving budget composition through the implementation of the tax reform and improved execution of public investments, and the implementation of an ambitious structural reform program are needed to support the development of the private sector as the main engine of inclusive growth in the future.
- **Protecting the vulnerable segments of the population,** by strengthening social protection mechanisms and conducting a systematic evaluation of the social impact of the programmed reforms.

### A. Short-term Objectives: Restore Fiscal and External Buffers

#### Fiscal policy

**5. Increased revenue mobilization will enable us to reduce the budget deficit in 2014 so as to contain pressures on the balance of payments and limit financing constraints.** The end-September fiscal target was met by a significant margin, primarily owing to a gain in revenue (0.5 percent of GDP) from taxes on oil companies programmed for 2013 but received in 2014, and stronger VAT receipts (12 percent growth year on year). For the full year, we expect a reduction of the structural deficit—deficit excluding the effects associated with the economic cycle and the transactions linked to the recapitalization of banks—to 4.1 percent of GDP (compared to 4.5 percent of GDP in 2013 and 4.7 percent of GDP under the program). This will ease financing constraints (cf. below) resulting from reductions in contributions from the development partners, and will contain pressures on the balance of payments. The improved fiscal position comes despite constraints presented in the supplementary budget law in regard to transfers for the national retirement and pension fund (CNRPS), and additional payments for the elections, security personnel, and salaries following sectoral agreements concluded with various trade unions in 2011. For the remaining months, the deficit reduction will entail:

- **Revenue.** Tax revenue will represent 22.7 percent of GDP (compared to 22.3 percent under the program and despite weaker economic activity than anticipated), supported by increased collection efforts (including the new regulations requiring government suppliers to submit tax clearance certificates), and the implementation of the revenue measures included in the

supplementary budget (Table 3). We are aware, however, that this revenue will only represent 22 percent of GDP if we exclude nonrecurring revenues (from oil companies and exceptional contributions from employees and enterprises).

- **Expenditure.** We will continue to contain the wage bill through a programmed reduction in net hiring—except for security forces, health and education—and control of promotions. We will keep our commitment to maintain energy subsidies at the programmed level, thanks to lower international oil prices, which have offset the greater than expected exchange rate depreciation in recent months. We continued to meet the threshold for social spending at end-June 2014, but were not able to do so at end-September because of a delay in expenditures for needy families, which will be recouped by year-end. The pace of execution of investment expenditures is expected to accelerate at year-end, bringing the execution rate close to 90 percent of the budgeted amount for 2014.

## **6. The fiscal adjustment started in 2014 will continue in 2015 to reduce financing requirements, maintain debt sustainability, and reduce pressures on the balance of payments.**

Fiscal consolidation—as spelled out in our 2015 budget, submitted to the Constituent Assembly in October 2014 and to be approved by Parliament by end-December 2014 (new structural benchmark)—is particularly necessary as our public debt becomes increasingly exposed to exogenous shocks. In this regard, we commit ourselves to reducing the structural deficit to 3.8 percent of GDP in 2015 while preserving the public investments and priority social expenditures needed to revive growth and protect the most vulnerable. The following measures detail our strategy:

- **Revenue.** Revenue register a further nominal increase of 6.5 percent, mostly reflecting the full year’s effects of the tax measures (0.2 percent of GDP) implemented with the supplementary 2014 budget (Table 3); the efforts to recoup arrears (0.2 percent of GDP), and modernized tax administration (see Section B).
- **Reduction of energy subsidies.** The full-year effect of the the elimination of energy subsidies for cement companies, and the electricity rate and fuel price increases of 2014, will generate savings of 0.3 percent of GDP in 2015. In addition, new measures will be put in place as part of our policy of reducing generalized energy subsidies, i.e., a 7 percent electricity rate increase in January 2015 for industrial and low-voltage consumers; and a 3 percent fuel price increase by March 2015, followed by another one by September 2015. Those measures are expected to generate further savings of 0.4 percent of GDP, in addition to the savings resulting from lower international prices, which will be locked in through forward contracts that will ensure oil imports for the first six months of 2015 (savings of 0.4 percent of GDP price originally envisaged under the program). The measures will be accompanied by social programs (see Section C) and the most disadvantaged population groups will continue to be protected through the institution of a social tariff for households consuming less than 100 kWh per month.
- **Control of the wage bill.** Our commitment is to contain the wage bill to a nominal increase of 6.6 percent relative to 2014, by limiting salary increases to no more than inflation and freezing net hiring other than for security forces and teaching and healthcare personnel. To better control the

wage bill, the Council of Ministers adopted in September 2014 a decree creating a civil service steering and monitoring commission, and will validate the recently completed World Bank report on the civil service career management and performance evaluation system. The report will serve as the basis for a civil service reform that will include proposals introducing greater mobility between the public and private sectors, and allowing the rationalization of civil servants. Technical support will be requested from the World Bank/European Union to analyze the government salary structure.

**7. We also remain committed to taking additional measures to correct any deviation from the budgetary targets under the program,** including reducing current expenditures (i.e., goods and services and subsidies) that were a source of budget overruns in the past. Public investment and social spending (excluding subsidies) will be preserved, and will not be constrained by our fiscal consolidation strategy. In light of uncertainties as to the evolution of international commodity prices, any oil price decline below the budgeted level (\$95/barrel) will be saved to further reduce the budget deficit.

**8. Larger than planned domestic borrowing and international bond issuance will partially offset weaker external budget support by the end of the year.** The mobilization of TND 959 million at end-July 2014 through the national borrowing campaign, and of \$1 billion through international bonds (issued with guarantees from the United States and Japan) will help offset the partial postponement to 2015 of the World Bank (\$500 million) and European Union (EUR 100 million) budget support, the IMF disbursement planned for the last quarter of 2014 (\$330 million), and of sukuks, given legal difficulties in the issuance process. Despite weaker contributions than anticipated, better fiscal performance and domestic borrowing will enable us to meet our financing needs.

## Monetary policy

**9. Monetary aggregates remain broadly in line with program objectives.** The criterion on net domestic assets at end-September has been met (after adjustment), primarily owing to a substantial reduction of bank refinancing, which offset the larger than anticipated increase in net credit to the government. Central bank refinancing of banks currently represents TND 4.3 billion (TND 3.8 billion excluding open market operations, OMO) largely resulting from additional liquidity following the repayment of two maturities of T-bills (BTA) during 2014, tourist receipts combined with weaker demand for liquidity from public enterprises (e.g. the Office des Céréales), and the use of foreign currency/dinar swaps among banks, which enabled them to reduce their reliance on the CBT. In addition, credit to the private sector grew by 8.4 percent (end-September, year on year), driven in part by consumer credit (9.6 percent, year on year).

**10. Monetary policy tightening remains necessary to reduce future inflationary pressures.** In response to inflationary pressures arising from private sector salary increases and the minimum wage, the depreciation of the exchange rate, and increased electricity and fuel prices, we raised the policy rate last June by 25 basis points, to 4.75 percent. The recent rise of core inflation and the producer prices index raise concerns despite the negative output gap that still characterizes our economy. To this end, we will continue to improve our communication to better anchor inflation expectations and signal the need to gradually achieve a positive real interest rate that will maintain inflation below the 6 percent



threshold. We stand ready to raise the policy rate if inflationary pressures increase more than expected, especially in the event of worsening external imbalances.

**11. The reform of the monetary policy framework is continuing.** The CBT is continuing to reduce the risks to its balance sheet arising from refinancing operations and considers that all banks are prepared for the increase in the minimum share of government securities from 20 percent to 40 percent (structural benchmark at end-December 2014). Following the July implementation of a 25 percent haircut on loans accepted as collateral for CBT refinancing, we intend to improve the current haircut system through rating instruments, which will require a gradual approach and dedicated technical assistance. In addition, we will continue to reduce direct refinancing through the CBT by increasing the use of OMO, the outstanding balance of which recently declined by half to TND 477 million. The study on evaluating public securities at market price instead of their nominal value was completed, and the implementation of the valuation is planned by December 2014 (we anticipate a minimal impact, given current rates).

**12. The implementation of a lender of last resort (LOLR) mechanism is needed to accompany the tightening of the eligibility criteria for CBT refinancing.** The LOLR initially envisioned for end-June 2014 (structural benchmark) will not be completed until May 2015 (new structural benchmark), given the need to establish the eligibility criteria and implement the new legal and institutional framework for bank resolution. However, as indicated in the context of the fourth review, a new, temporary “exceptional facility” was put in place in July 2014 on the basis of collateral not commonly accepted by the CBT management and at a penalty rate.

**13. Modifications to the system of excessive bank lending rates will enhance the monetary policy transmission channel and access to financing.** The recent increase of the money market rate led to an increase of the overall effective rate (TEG) and eliminated restrictions on banking credit tied to the TEG in the short term. However, consultations will continue with the ministerial departments concerned, to assess and revise if needed, by December 2014, the text of the law on excessive lending rates, with a view to improving the channels of transmission of monetary policy and access to credit for small and medium-sized enterprises (SMEs).

**14. The central bank law is under revision.** A comprehensive set of amendments to the law are intended to provide the CBT with greater autonomy (in institutional, operational, staffing, and financial terms) and better define its mandate (through clarification of its objectives, missions, and tools) while strengthening its governance, transparency, and accountability. The draft law, prepared with IMF technical assistance, was presented to the CBT board of directors in June 2014 (structural benchmark) and will be adopted by the government by March 2015.

## Exchange rate policy

### 15. Pressures on the foreign exchange market declined, reflecting a greater supply of currency from tourist receipts, transfers from migrant workers, and external budget support.

Transactions in the foreign exchange market decreased by 40 percent between June and September 2014. The provision of foreign currency to banks also allowed a more active use of foreign currency swaps among banks, thereby reducing pressure on dinar liquidity. The CBT also reduced its interventions on the exchange market (foreign currency sales); these were halved (to \$200 million per month), though they remain necessary to ensure settlement of external payments relating to energy imports. Thus our stock of reserves increased by \$600 million during the third quarter, with the exchange rate following a downward trend and depreciating 14 percent against the U.S. dollar and 4 percent against the euro since mid-March 2014. Given the deterioration of the trade deficit and the need to reconstitute our foreign reserves, we will pursue our policy of a more flexible exchange rate by:

- **Continuing to limit CBT's interventions on the foreign exchange market.** We are committed to refraining from selling foreign currency on the exchange market except for smoothing fluctuations that may result if large orders related to energy transactions are not met. To preserve and build our foreign reserves, we intend to intervene by purchasing foreign currency on the market, particularly when there is no strong demand for foreign currency associated with energy imports.
- **Introducing weekly foreign currency auctions in December 2014** (structural benchmark). To this end, the launch of the electronic platform providing interconnection between banks and the entry into force of the market-maker agreement (eight banks having signed the agreement in September) will provide us with real-time information on the price quotations of different participants in the exchange market. However, the introduction of the auction mechanism will also require the implementation, with IMF technical assistance, of an effective information system enabling the CBT to centralize flows of projected foreign currency settlements and provide it with a clearer view of cash flows.

**16. Our development strategy will remain open and based on free trade.** We have taken measures to reduce the growing trade deficit by promoting our exports and rebalancing our energy mix. Following the World Trade Organization rules, we will not consider the introduction of new restrictions or import surcharges except as a last resort, after exhausting all market-based solutions that preserve adequate incentives, and only with very clear criteria, announced in advance, for removing them.

## B. The Foundation for Inclusive Growth

### Financial sector policies

**17. The Tunisian banking system remains fragile despite indicators that continue to show profitability in a still-difficult domestic context.** The end-June indicators show deteriorating asset quality, with nonperforming loans up from 14.9 percent in 2012 to 16 percent at end-June 2014 (roughly 21 percent if we include loans transferred to asset recovery agencies affiliated with the banks)—primarily in the sectors most affected by the continued anemic economic activity (tourism, manufacturing). At the same time, the more rigorous imposition of haircuts on collateral increased the provisioning rate for

nonperforming loans from 45 percent in 2012 to nearly 60 percent at end-June 2014. On the other hand, the rise in financial fees and capital gains on government securities continues to support the growth of net banking income. In the prudential area, the capital adequacy ratio (CAR) fell to 8.8 percent (six banks remain below the minimum threshold required by the current regulation). In regard to liquidity, only eight of the 22 banks comply with the regulatory ratio of 100 percent.

**18. The restructuring of the banking system—which will result in a refocusing of the government’s role in public banks—remains an absolute priority.** The restructuring plans for two public banks (STB and BH) were finalized based on the results of the audits on the 2012 financial statements and adopted by the government in August 2014 according to sound international practices. The plans are intended to ensure the banks’ financial soundness, establish a new governance framework, provide the resources to write off nonperforming loans, build institutional capacities, and strengthen the legal framework. The audit of the Banque Nationale Agricole (BNA) has been finalized (with a slight delay relative to program commitments), and its associated restructuring plan has been presented to the Council of ministers, but will not be finalized in line with good international practices until recapitalization modalities are set (structural benchmark for end-November). In the short term, our action plan for the public banks is based on the following priorities – some of which are still contingent on banks’ general assembly decisions and on the legislative calendar:

- **Strengthening of governance and operational restructuring.** The new governance decree grants public banks greater autonomy vis-à-vis the government. In accordance with the planned timetable, a joint committee adopted the terms of reference for the new selection and evaluation criteria for members of the board of directors, and we plan to overhaul directors’ compensation and replace members of the board according to fit and proper criteria by end-January 2015 (new structural benchmark); a change in senior bank managers will follow suit. To ensure that public banks operate strictly on the basis of commercial criteria in accordance with sound management practices, we will prepare performance contracts to be finalized for the three public banks by March 2015 (new structural benchmark), but whose implementation remains contingent on the adoption of the recapitalization plans. The performance contracts will aim, inter alia, for the convergence of performance indicators toward the levels of private sector banks by 2016 (e.g., a cost-to-income ratio on the order of 40–45 percent) and on a consolidated basis for certain ratios. These performance contracts will be aligned with the restructuring plans adopted by banks’ extraordinary assemblies, following good international practices and including the results of the audits (structural benchmark for end-March 2015).
- **The recapitalization of public banks.** The recapitalization plan approved by the government in August 2014 could not be implemented, given the lack of authority to use public funds already allocated for the recapitalization and because of the need to continue discussions with private shareholders with the aim of ensuring the recapitalization process is in line with sound international practices (see Annex). These include: (i) recapitalizing in one single step with the amount necessary to ensure compliance with prudential regulations, after allocating losses before any injections of capital or allowing for immediate dilution of private shareholders who do not take part in the capital increase; (ii) setting the size of the recapitalization on the basis of the audit results, and adding the

cost of operational restructuring measures and measures to support the reduction of staff. In light of the delays in the implementation of the recapitalization plans, the three public banks will not meet the capital adequacy requirements (10 percent) before May 2015. Substantial cost—in addition to the 1.2 percent of GDP already allocated in the national budget—will also be assumed in 2015 to implement the rehabilitation program, including the required institutional and commercial investments. An extraordinary general assembly of the banks' shareholders will be held as soon as possible to ratify the plans in line with sound international practices.

- **Asset Management Company (AMC).** The AMC was created in the 2014 supplementary budget law, which defines its objectives and authorizes the government to subscribe TND 150 million of its capital. The AMC's creation will not be effective nor considered operational until the AMC law is adopted by Parliament. This law, which will establish the key principles of the AMC and provide specific powers to expedite the resolution and restructuring of the transferred loans—could not be adopted in September 2014 and, with the current parliament in recess, will not be considered until the new Parliament is in place. The law will be accompanied by implementation decrees that will determine, inter alia, the rules of governance, the fair transfer price for loans, and the specific terms and procedures for financing the AMC operations, which will follow sound international practices (new structural benchmark for end-April 2015). Although the draft law provides for the creation of a universal AMC, the initial implementation phase will be limited to the tourism sector. Moreover, we will submit to the next Parliament some amendments to Law 98 on the existing credit recovery companies to enable them to act more effectively.

**19. Ensuring banks' adherence to prudential standards remains an essential goal.** To this end, banks that breached risk concentration rules have regularized their positions, except those for which a restructuring plan is in place. Private banks not meeting the minimum solvency ratio have submitted a recapitalization plan to ensure compliance with the applicable regulations at end-December 2014 (structural benchmark). This deadline has been postponed to May 2015 for public banks under a recapitalization plan duly approved by the CBT and subordinated to the legislative authority for using funds already allocated in the budget. We also promulgated a circular in October introducing a new liquidity ratio, calculated on an individual basis and including off-balance-sheet positions, to be implemented gradually according to a specific timetable announcing a minimum ratio of 60 percent applicable from January 2015, increased by increments of 10 percent per year up to 100 percent in 2019. It will be supplemented by qualitative requirements designed to align liquidity risk management with sound international practices.

**20. Banking supervision reforms continue to be an absolute priority.** In June 2014, with IMF technical assistance, we prepared a three-year plan (including prerequisites), adopted by CBT management in June 2014, for promoting risk-based banking supervision, assessed on an individual and consolidated basis. Our short-term priorities are to:

- **Strengthen the human resources of the Directorate General of Bank Supervision (DGSB).** We are aware that the success of our action plan will depend on the personnel and financial resources provided to the DGSB. Accordingly, and given the urgency imposed by the loss of experienced staff, we intend to conduct a competitive recruitment to hire 12 new supervisors (end-November SB); we

will not be able to hire the new recruits by the end of 2014, as originally planned, but by March 2015 instead. A new code of ethics for supervisors will be designed and implemented by December 2014—particularly to prevent any conflict of interest for personnel leaving the DGSB.

- **Improve reporting.** In September 2014, the CBT completed work on the uniform bank performance reporting indicator (UBPR), which will be available 60 days after the end of each quarter and will be used jointly by the DGSB and the Directorate General of Financial Stability and Risk Prevention (DGSFPR). The UBPR will then be disseminated to banks, the first report being based on the banks' financial situation as of end-June 2014. In addition to this mechanism, a new reporting system of accounting, financial, and institutional data on banks will also be implemented with IMF technical assistance in December 2014 (structural benchmark) and automated in June 2015. These efforts will be complemented by the institution of a risk profile rating system for credit institutions, which will also be designed by December 2014 with IMF technical assistance.
- **Strengthen on-site inspections and integrate them into the banking supervision process.** We conducted one general inspection mission this year and could not meet our objective (four missions) because of a lack of resources. The DGSB's effectiveness will be enhanced by formalizing the competencies and responsibilities of the different DGSB divisional units and establishing a memorandum of understanding specifying the modalities of their cooperation—including cooperation between units responsible for on-site and off-site audits or surveillance—by April 2015 following technical assistance from the IMF. Coordination with other CBT units (in particular the DGSFPR) will also be strengthened and formalized. Weak banks will be identified and subject to heightened supervision based on criteria to be formalized by February 2015, and following additional technical assistance.
- **Strengthen the banks' internal controls.** On the basis of 2013 reports on internal control and risk management, the DGSB has analyzed the banks' credit risk management systems and has required those with inadequate systems to submit action plans by end-December 2014. These reports on internal controls expected in 2014 will also be closely examined, including with respect to risk exposure not addressed by quantitative prudential standards (notably operational risk, market risk, medium-term liquidity mismatch risk, overall rate risk).
- **Strengthen preventive surveillance of vulnerability factors.** The DGSB, in cooperation with the DGSFPR, will prepare by February 2015 a formal program of periodic stress tests designed to detect banks' vulnerability to extreme but plausible shocks, not only from the standpoint of credit risk but also in terms of liquidity, interest rate, and exchange rate risks.

**21. A bank crisis and resolution management mechanism, in line with best international practices, is currently being finalized.** A draft banking law was prepared with technical assistance from the World Bank and the IMF to strengthen banking supervision and regulation in Tunisia and establish a sound legal framework for the resolution of insolvent banks. The draft law, which was presented to the CBT board of directors in June 2014, will be adopted by Parliament in March 2015 (new structural benchmark). The proposed amendments to the proposed CBT law will also strengthen the banking resolution framework.

**22. The implementation of a lender of last resort (LOLR) mechanism and deposit guarantee fund is necessary to ensure financial stability.** With technical assistance from the World Bank, we are finalizing an overall plan to provide explicit guarantees for the deposits of the public. The mechanism will strengthen the stability of the banking sector. It will be presented to the CBT board of directors in January 2015. The deposit guarantee law will be presented to the Parliament in March 2015. The operational implementation is expected to take place in May 2015.

### **Fiscal reforms**

**23. Our medium-term fiscal consolidation strategy is accompanied by fiscal reforms to support inclusive growth.** The reforms aim to overhaul tax policy, modernize tax administration, strengthen the governance of public enterprises, improve public expenditure management, and enhance the effectiveness of public investment.

**24. The equity, efficiency, and transparency of the tax system continue to be the key pillars of our tax policy, together with revenue mobilization.** All existing tax laws and codes were consolidated in a single tax code that was approved and presented to Parliament in October 2014 (structural benchmark for end-September), thereby enhancing the transparency of the tax system. The National Tax Consultations were held on November 2014, which delayed the Council of Ministers' adoption of the action plan to end-December 2014 (structural benchmark at end-October). In the context of the overall tax system reform, we intend to continue revising the corporate tax to achieve the gradual convergence of the offshore and onshore sector rates—the difference between the two rates was reduced by half in the 2014 budget law—which will be announced according to a clear timetable (structural benchmark at end-May 2015) and closely coordinated with the improvement of the tax administration. For the time being, we have improved equity by transferring a number of professions from the presumptive tax system to taxation based on actual earnings, aligning the treatment of liberal professions to their peers in the civil service.

**25. The reform of the tax administration is moving forward.** We have strengthened tax audits by lifting the provisions of the banking system that hinder the collection and use of information for the purpose of tax audits (including audits for taxpayers benefitting from the presumptive tax system), and have improved our collection efforts through the introduction of a tax clearance certificate for all government suppliers. These short-term actions are part of the new tax administration modernization plan we adopted in June 2014 that aims to establish a unified tax administration and strengthen the mechanisms of monitoring and evaluation. The implementation of the plan will benefit from the creation of a new unit within the General Directorate of Taxes (DGI) in charge of the modernization, and to be established with help from IMF technical assistance. For the end of the year, we expect to implement "selective audit procedures" and evaluate the DGI institutional framework to eliminate existing rigidities and facilitate reform implementation. To enhance the effectiveness of the tax administration, we plan to introduce in the 2015 budget law the legal framework allowing the creation of a new category of public accountants, called "tax collectors", by January 2015 (structural benchmark), with the aim of integrating the collection function from the General Directorate of Public Accounting and Collection (DGCPA) into the DGI. This change will be start at the Large Taxpayers Unit in the first half of 2015.

**26. The monitoring of public enterprises' performance was strengthened.** Measures to put companies on a sounder financial footing and restructuring plans—including a business plan and the social component accompanying the reduction in staff—were adopted for some of the most vulnerable national enterprises, particularly in the transport sector. These plans will improve the governance of these enterprises. The gains from this experience and that of public banks will be gradually extended to other public enterprises through the implementation of a new regulatory framework. In addition, monitoring of public enterprises, which started with the preparation of a report on the financial position of 28 public enterprises, will continue by instituting an early warning system to detect signs of financial difficulties and by the approval of performance contracts for the 5 largest companies posing fiscal risks (new structural benchmark for April 2015). It will also be improved by a better monitoring of public enterprises, including by a possible consolidation of entities charged with their monitoring, which will be decided in a strategy to be adopted by the government by April 2015 (new structural benchmark). For the enterprises in the energy sector, the priorities, as indicated in the audit report, which will be published in December 2014, will focus on the improvement of collection and expenditure management and the elimination, as of January 1, 2015, of cross-subsidies for STEG and STIR, which will meet their energy requirements by importing directly rather than going through the refinery company ETAP.

**27. Efforts to improve public expenditure management continue.** All 2013 expenditures authorized during the carryover period were paid. Moreover, to avoid slippages this year, the government decided to close all payment orders (with the exception of salaries, debt service and subsidies) on December 15, 2014 to ensure that effective payments are made in 2014, and to institute procedures to reduce the time required to close the accounts. The draft organic law, prepared with technical assistance from the European Union and France, will be approved by the Council of Ministers in December 2014, facilitating progress on all fronts: budget design, budget information (new functional nomenclature), expenditure control, and execution and control. The decree creating a National Board on Standards for Public Accounts to introduce double-entry bookkeeping based on international standards and a new budget and accounting nomenclature will be adopted by the government in December 2014 and will become operational in 2015. In addition, the reform on performance budgeting is moving ahead, with the third wave of ministries preparing their budgets according to the new programmatic nomenclature.

**28. Our efforts to accelerate public investment continue.** The new procurement procedures that took effect on June 1, 2014 will considerably simplify and modernize procedures and accelerate public investment in the regions. We are convinced that professionalization and decentralization of the management of regional public projects, and the implementation of procedures to remedy land deeds problems during project preparation will accelerate the pace of capital expenditures. In this context, a report on constraints to project implementation is being finalized, and a mechanism for close coordination between the governorates and the central administration was put in place to reduce constraints on important projects. In the medium term, and following the recommendations of IMF technical assistance, we plan to establish a national body in charge of directing investments and define a methodology for project evaluation and selection.

## Structural reforms

**29. Our structural reform program will continue to focus on improving the business climate and promoting a competitive private sector that can generate inclusive growth.** The approval of the “economic” laws—initially deferred because of the NCA’s heavy workload linked to approaching electoral deadlines—could not be achieved before the NCA’s recess despite our efforts to push forward the the legislative calendar. These delays imply that the laws will not be approved until 2015, in the aftermath of the elections; thereby postponing the removal of constraints to private sector development to 2015:

- **The law on collective procedures (Law 95-34 on the recovery of enterprises in economic difficulty).** In parallel with the reform of the banking law, we embarked on a process to adopt a new law on collective procedures prepared with World Bank assistance. The law will modernize and simplify the process of restructuring companies and liquidating insolvent companies. We are committed to ensuring that the new legislation provides clear rules with respect to the government’s status as preferred creditor, and grant the right of private creditors to vote on reorganization plans.
- **The competition law.** The draft law, submitted to the NCA in 2013, was validated by the parliamentary committees and is awaiting to be reviewed by the full Assembly. The law aims at reducing government’s intervention in the economy, lessen excessive regulation, and enhance competition between companies .
- **The law on public-private partnerships.** The draft law, which will facilitate private concessions, was reviewed by the parliamentary committees, and they have already submitted a favorable report. The law is expected to be debated by the full assembly when the legislative session resumes.

**30. The investment code, prepared with World Bank technical assistance and following consultations with civil society and donors, was withdrawn from the NCA to be modified and simplified.** The government concluded that the new code, which was intended to encourage private investment through a more transparent and efficient regulatory framework and rationalized incentives, was too complex and left too much discretion to the implementation decrees. Nonetheless, we remain convinced that a new, simplified investment code is necessary and have resumed efforts to revise it by May 2015 (structural benchmark). Accordingly, in September 2014 we introduced a list of measures to reduce restrictions on investments, which are designed to supplement the current code.

**31. In parallel with the amendments to the relevant laws, the efforts to simplify administrative procedures continue.** We have rationalized a number of administrative procedures that were hampering the private sector in the areas of transport, customs, and exports. We remain committed to continuing on this path, encouraged by the anticipated results of the regulatory “guillotine” project.

**32. We are committed to reducing obstacles to a proper functioning of the labor market.** We aimed at creating 50,000 jobs this year, particularly with programs favoring youths and residents of



disadvantaged areas. Those programs include, among others, occupational training programs, programs to support SMEs (financed by the World Bank), and micro projects (financed through loans from the Solidarity Bank and the National Employment Fund), as well as the establishment of solidarity enterprises to support young graduates in disadvantaged areas. In regard to the national employment strategy, discussions on implementing the social contract signed on January 14, 2013 between employers and trade unions have begun; these, following extensive consultations, will lead to a new national employment strategy. A labor market reform will follow, including an evaluation of “flexsecurity” in labor relations and reduction of the structural skill mismatch that prevails in the market.

**33. Reliable statistical information is essential to monitoring and evaluating macroeconomic policies and the implementation of social programs.** In this context, a comprehensive diagnostic assessment of our statistics system was completed by Eurostat, and we plan, with IMF technical assistance, to strengthen our institutional mechanism and system of producing the national accounts (annual and quarterly), monetary statistics, and the balance of payments. We have also published the initial results of the 2014 census, which will constitute the foundation for revamping surveys on employment, consumption, and household living conditions. In parallel, a “National Statistics Charter” promoting good practices in statistics will be adopted by December 2014, and consideration is under way on a legal framework to ensure and protect the independence of the National Statistics Institute (INS).

### C. Protecting the Most Vulnerable

**34. Protecting the most vulnerable is a priority during the implementation of fiscal and structural reforms.** To this end, and to continue improving our targeting systems, we completed an evaluation of school assistance programs that shows little leakage to non-targeted groups. The evaluation of the program of assistance to families in need (250,000 families) and health benefits cards (550,000), conducted based on a representative sample of 8,000 households, is currently being finalized and will provide, for the first time, information on the population working in the informal sector. The preliminary results indicate inclusion errors, but fewer than anticipated, in favor of the nonpoor, notably in the discounted health benefits card program (AMG2). We are aware that the reform of social protection policies should continue to move toward better-targeted programs. Until now, these policies were characterized by specific household support programs (increasing existing transfers or expanding beneficiaries), but we are moving toward a complete reform of the social protection system based on the following priorities:

- We will accelerate our efforts on the unique social identifier, which is now finalized for 8.5 million individuals (persons covered by the different social security regimes and their beneficiaries). The identifier, cross-checked with data from the civil registry and the social security database, will be completed in the coming months as the “exclusion and inclusion errors” are corrected. The inclusion of social assistance beneficiaries (of cash transfers and health benefits cards) in the unique social identifier system is also planned.

- Specific measures for better targeting of energy subsidies to households, designed by an ad-hoc commission created in July 2014, are now under government review, and a reform scenario will be subsequently adopted.
- We will begin development, with World Bank technical assistance, of a communication strategy that will be put in place after the modalities of a new targeting program are established.

**35. The deficit of the pension system calls for urgent reform.** The national retirement and social security fund (CNRPS) is expected to post an annual deficit of TND 410 million (about 0.5 percent of GDP) in 2014 and currently has no available cash reserves. For this year, the government decided to provide a transfer of TND 250 million as a counterpart to receivables from certain public enterprises experiencing financial difficulties, in particular public transport companies. For 2015 and in the context of implementing the social contract, consultations with our social partners are under way to find urgent solutions including, in particular, increasing payroll contributions and delaying the retirement age. The adoption of these solutions should be part of a comprehensive reform of the retirement and health insurance system, in order to ensure the system's long-term sustainability.

## Annex. Principles for Successful Restructuring of Public Banks

The best experiences with restructuring plans include **a clear, specific timetable and the following pillars:**

### Financial restructuring

The purpose of financial restructuring is to restore solvency (net assets) by rehabilitating and strengthening banks' balance sheets.

- Existing and new fit-and-proper private shareholders should be asked to contribute to recapitalization through cash injection. Existing shareholders will bring the bank to solvency if needed, and public funds can be used to bring the bank back to minimum capital requirements once sources of private capital have been exhausted.
- Before any public funds are injected, the shares of existing shareholders have to be diluted or the overall loss has to be distributed amongst them.
- The government should seek authorization in a supplementary budget if the government's share of the recapitalization costs is higher than the budgeted amount.

### Operational restructuring

Operational restructuring aims at creating the conditions for restoring banks' sustained solvency and profitability.

- To ensure good corporate governance, Bank Board members representing the State and bank managers are fit and proper and professionally suitable; and a relationship framework should be signed to govern the interaction between the Finance Ministry and each state-owned bank. The latter will help ensure no political interference in banks' commercial operations.
- To ensure effective governance and communication in the use of public funds for bank recapitalization and restructuring, the following requirements will need to be set:
  - a. A high-level committee comprising the Minister of Finance and the CBT Governor should be established to coordinate the process, including approval of the overall strategy and monitoring of progress;
  - b. The committee should appoint a spokesperson to be in charge of the communication strategy of the recapitalization and restructuring process, to ensure timely and consistent information to the public;
  - c. The State's interest in the banks should be managed in a dedicated, specialized unit set up at the Ministry of Finance.

**Table 1. Tunisia: Quantitative Performance Criteria and Indicative Target, 1/2/**

	Cumulative Flows Since the Beginning of 2014														
	Mar 2014			Jun 2014				Sep 2014				Dec 2014		Mar 2015	
	Adjusted target	Actual	PC Status	Prog. 04/25/14	Adjusted target	Actual	PC Status	Prog. 08/29/14	Adjusted target	Actual	PC Status	Prog. 08/29/14	Revised PC	New PC	
<b>Quantitative Performance Criteria</b>	(Millions of Tunisian Dinars)														
1. Floor on the primary balance of the central government (cash basis excl. grants)		-1,116	Met	-2,806		-1,549	Met	-3,793		-2,386	Met	-5,587	-4,374	-1,162	
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock)	4,327	2,457	Met	4,086	4,903	3,371	Met	3,961	5,115	2,842	Met	1,466	3,187	2,711	
	(Millions of US\$)														
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock)	5,067	5,180	Met	4,754	4,228	4,342	Met	5,487	4,744	5,005	Met	6,877	5,709	6,058	
<b>Continuous Performance Criteria</b>	(Millions of Tunisian Dinars)														
4. Ceiling on the accumulation of new external debt payment arrears by the central government		0	Met	0		0	Met	0		0	Met	0	0	0	
<b>Quantitative Indicative Targets</b>	(Millions of Tunisian Dinars)														
5. Ceiling on Current Primary Expenditure		4,058	Met	8,267		7,745	Met	12,915		11,910	Met	18,033	18,191	4,860	
6. Floor on Social Spending 3/		282	Met	562		624	Met	962		836	Not Met	1,412	1,412	310	
7. Ceiling on the accumulation of new domestic arrears		0	Met	0		0	Met	0		0	Met	0	0	0	
<b>Program assumptions on which adjusters are calculated in case of deviations</b>															
External Financing of the central government on a cumulative basis (in US\$ million) 4/ <i>of which:</i> Multilateral (excluding IMF), bilateral and budget grants		230		707		269		1,438		1178		2,647	1996	894	
Public debt service (interest and amortization) on a cumulative basis (in US\$ million)		203		506		459		662		655		913	894	230	
Bank recapitalization (in million TD)		0		0		0		300		0		700	0	0	
Privatization receipts (in million USD)		0		0		0		0		0		0	0	0	
Resident deposits at the BCT (in million USD) 5/		1,852		1,852		1,607		1,852		1,389		1,852	1,852	1,852	
<b>Program exchange rate TD/ U.S. dollars</b>				1.55235		1.55235		1.55235	1.55235	1.55235		1.55235	1.55235	1.55235	

1/ Quantitative performance criteria and structural benchmarks are described in the Technical Memorandum of Understanding.

2/ For purposes of calculating program adjusters, foreign currency amounts will be converted at program exchange rates.

3/ Public capital expenditures on social sectors and programs.

4/ Disbursement, includes project loans and capital market access but excludes IMF budget support.

5/ At program exchange rate.

Table 2a. Tunisia: Structural Benchmarks for the Period July–December 2014

	Objective	Date	New Date	Comments
<b>I. Financial sector</b>				
Completion of the financial audit of the Banque National Agricole (BNA)	<i>Financial sector stability</i>	<i>Jul-14</i>	<i>Sep-14</i>	<b>Met</b> with delay in November 2014.
Creation of Asset Management Company (AMC) through the publication in the Official Journal of the Law on the AMC.	<i>Financial sector stability</i>	<i>Sep-14</i>	<i>Apr-15</i>	<b>Not met.</b> Reset to April 2015. The adoption of Article 4 of the supplementary budget defined the objectives of the AMC. The law granting juridical personality to the AMC could not be adopted before the parliamentary recess and will be adopted in 2015 in the next session of Parliament.
Adoption by the Government of the BNA restructuring plan.	<i>Financial sector stability</i>	<i>Nov-14</i>		<b>Not met.</b> The audit has been completed, and options for a sound restructuring are being assessed, and presented to the Board of Directors on November 11, 2014. The plan will follow sound international practices once the recapitalization modalities are defined and the restructuring option has been chosen.
Double the number of DGSB supervisors and revise the CBT hiring criteria to facilitate the hiring of qualified personnel.	<i>Financial sector stability</i>	<i>Nov-14</i>	<i>Mar-15</i>	<b>Not met.</b> Reset to March 2015.
All banks, including public banks, to comply with minimum solvency ratio required by the existing regulations (10 percent)	<i>Financial sector stability</i>	<i>Dec.-14</i>	<i>May-15</i>	<b>Not Met.</b> The minimum ratio will be met by private banks by end-December 2014, but delayed to May 2015 for public banks, which still have to be recapitalized.
Development and implementation of the new reporting and rating system for banks	<i>Financial sector stability</i>	<i>Dec-14</i>		<b>In progress.</b> Work on the new rating and reporting system is in progress with technical assistance from the IMF.
<b>II. Fiscal policy</b>				
Government approval of the new tax code	<i>Enhance transparency of the tax system</i>	<i>Sep-14</i>		<b>Met</b> with delay. All norms and regulations were consolidated in a single text submitted to the ANC in October 2014.
Following national consultations on taxation, adoption of a tax reform plan covering direct and indirect taxes by the Council of Ministers.	<i>Expand the tax base and improve equity</i>	<i>Oct-2014</i>	<i>Dec.-2014</i>	<b>Not met.</b> The national consultations took place in November and validated a reform plan which will be adopted by the Government in December 2014.
Parliamentary Approval of the 2015 budget	<i>Fiscal sustainability</i>	<i>Dec-14</i>		
<b>III. Monetary and exchange policies</b>				
Ensure that the proportion of the refinancing volume at the CBT backed by government securities is at least 40 percent for each bank	<i>Enhancement of the monetary transmission mechanism</i>	<i>Dec-14</i>		<b>Met.</b> Circular issued in March 2014 and will take effect on January 1, 2015
Implementation of the weekly foreign exchange auction mechanism	<i>Greater exchange rate flexibility</i>	<i>Dec-14</i>		<b>In progress.</b> The hardware platform has been put in place, and the software will be put in place following IMF TA.
<b>IV. Structural reforms/private sector development</b>				
Decrees for implementing the new investment code, in line with the objective of protecting market access, reducing restrictions to investments and rationalizing incentives	<i>Support for balanced growth driven by the private sector</i>	<i>Sep-14</i>	<i>Delayed to May-2015</i>	<b>Not Met.</b> The decrees will not be submitted to Parliament because the government decided to withdraw the draft law on the investment code from parliament; a revised code will be prepared by May 2015.

Table 2b. Tunisia: Structural Benchmarks for the Period January–May 2015

	Objective	Date	Comments
<b>I. Financial sector</b>			
Designation of fit and proper Board members of the three public banks, with private sector experience.	<i>Financial sector stability</i>	<i>Jan-15</i>	
Adoption of recapitalization plans in line with sound international practices by the general assembly of the three public banks, following the criteria outlined in Annex 1 to the MEFP and based on the results of the audits.	<i>Financial sector stability</i>	<i>Mar-15</i>	
Approval by the Board of Directors of performance contracts in line with norms included in the bank restructuring plans for the STB, BH and BNA and subordinated to the approval of the respective recapitalization plans.	<i>Financial sector stability</i>	<i>Mar-15</i>	
Adoption by Parliament of the banking law (that includes a banking resolution framework) in line with sound international practices	<i>Financial sector stability</i>	<i>Mar-15</i>	
Publication, on the Official Gazette, of the law governing the functioning of the AMC in line with sound international practices, as well as Government adoption of the related implementation decrees.	<i>Financial sector stability</i>	<i>Apr-15</i>	<i>Reset and reformulated from September 2014.</i>
All banks, including public banks, to comply with minimum solvency ratio required by the existing regulations (10 percent)	<i>Financial sector stability</i>	<i>May-15</i>	<i>Reset from December 2014</i>
<b>II. Fiscal policy</b>			
Creation of a new category of public accountants called "tax collectors"	Enhance transparency of the tax system and revenue collection	<i>Jan-15</i>	
Adoption by the Government of a strategy for a better monitoring of operations and financial performance of public enterprises	Reduce fiscal risks	<i>Apr-15</i>	
Signature of performance contracts for the 5 largest state-owned companies	Reduce fiscal risks	<i>Apr-15</i>	
Adoption by the government of a calendar for the total convergence of the tax rates of onshore and offshore sectors	Minimize distortions, and tax fairness and simplification	<i>May-15</i>	
<b>III. Monetary and exchange policies</b>			
Establishment of the lender of last resort mechanism	<i>Financial system stability and better crisis management</i>	<i>May-15</i>	<i>Reset from June 2014.</i>
<b>IV. Structural reforms/private sector development</b>			
Revision of the new investment code in line with the objective to protect market access, reduce investment restrictions, and rationalize exemptions.	<i>Support for balanced growth driven by the private sector</i>	<i>Apr-15</i>	<i>Reset and reformulated from September 2014.</i>

**Table 3. Tunisia: Fiscal Measures included in Supplementary Budget 2014**

	In Millions of TD	In Percent of GDP
Tax Revenue	460	0.55
Vehicle taxes	15	0.02
Tourism taxes	75	0.09
Stamp taxes	30	0.04
Other tax measures incl. exceptional taxation on revenues <sup>1/</sup>	340	0.41
Current expenditure	7	0.01
Decreased energy subsidies	7	0.01
Total	467	0.56

1/ One-off tax contribution amounting to a total of 0.4 percent of GDP distributed as follows: (i) wages, contributing with 18 percent of the total amount through 1 to 6 days of wages depending on level of salaries; (ii) professionals, contributing with 9 percent of total amount through 15 percent of the sum of the second and third installments due in 2014; (iii) non-oil companies, contributing with 50 percent of the total amount through a minimum of 0.05 percent for installment of total domestic sales for 2014; and (iv) oil companies contributing with 23 percent of the total amount through 10 percent of the oil tax due in second half of 2013.

## Attachment II. Technical Memorandum of Understanding

1. This Memorandum establishes the agreement between the Tunisian authorities and IMF staff concerning the definition of the quantitative performance criteria and indicative targets. It also sets out the content and frequency of data reporting to IMF staff for program monitoring purposes.
2. The quantitative criteria and targets are defined in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated December 3, 2014. For program purposes, all assets, liabilities, and flows denominated in foreign currencies will be valued at the "program exchange rate," as defined below, with the exception of items affecting the government's budgetary accounts, which will be measured at current exchange rates. For program purposes, the exchange rate corresponds to the accounting exchange rate of the CBT prevailing on December 31, 2012, as shown in the table below. For the SDR, the program exchange rate is 1SDR = 2.38852 Tunisian dinars.

<b>Program Exchange Rates: Tunisian Dinar per FX Currency (Accounting Exchange Rate of the CBT) December 31, 2012</b>		
<u>Currency</u>	<u>Units</u>	<u>Average Rate</u>
Algerian dinar	10	0.19860
Saudi riyal	10	4.13930
Canadian dollar	1	1.56175
Danish krone	100	27.44020
USA dollar	1	1.55235
British pound sterling	1	2.50510
Japanese yen	1000	18.02650
Moroccan dirham	10	1.83535
Norwegian krone	100	27.73730
Swedish krona	10	2.37995
Swiss franc	10	16.95450
Kuwaiti dinar	1	5.51955
United Arab Emirates dirham	10	4.22660
Euro	1	2.04725
Libyan dinar	1	1.23740
Mauritanian ouguiya	100	0.51230
Bahraini dinar	1	4.11770
Qatari riyal	10	4.26380

Source: Central Bank of Tunisia.



3. Monetary gold assets will be valued at the price of 0.6498 dinar per gram of gold as established in the decree No. 86-785 of August 18, 1986. The stock of gold is 6.73 tons (6739902 grams) on December 31, 2012.

4. For data reporting purposes, the Ministry of Economy and Finance, the National Institute of Statistics (INS), and the Central Bank of Tunisia (CBT) will follow the rules and the format considered appropriate for data reporting as covered by this technical memorandum of understanding, unless otherwise agreed with IMF staff.

## DEFINITION OF PERFORMANCE CRITERIA AND INDICATIVE TARGETS

### A. Performance Criteria and Indicative Targets

5. **The quantitative performance criteria and indicative targets specified in Table 1 of the MEFP are:**

#### Performance criteria

- A performance criterion (floor) on the net international reserves of the Central Bank of Tunisia.
- A performance criterion on the net domestic assets (ceiling) of the Central Bank of Tunisia.
- A performance criterion (floor) on the primary balance of the central government, excluding grants.
- A continuous performance criterion on the accumulation of external arrears (zero ceiling).

#### Indicative targets

- An indicative target (ceiling) on total domestic arrears.
- An indicative target (ceiling) on total primary current expenditure of the central government.
- An indicative target (floor) on capital expenditures in priority social sectors and social programs.

6. **Measurement of criteria.** The performance criteria on net international reserves and net domestic assets are measured on a stock and quarterly basis. The performance criterion on the central government deficit is measured on a quarterly basis and cumulatively from the end of the previous year. Adjustment factors will also be applied to some of these criteria. The performance criterion on the accumulation of external arrears is measured on a continuous basis.

### B. Institutional Definition

7. The **central government** comprises all ministries and agencies subject to central budgetary administration in accordance with the organic law on the government budget. Regional

governments and municipalities subject to central budgetary administration are part of the central government.

8. The authorities will inform Fund staff of any new entity and any new program or special budgetary or extra-budgetary fund created during the period of the program to carry out operations of a budgetary nature. Such funds or new programs will be included in the definition of the central government.

### C. Floor on the Net International Reserves of the Central Bank of Tunisia

9. The **net international reserves (NIR)** of the Central Bank of Tunisia (CBT) are defined as the difference between the CBT's reserve assets and its liabilities in foreign currency to nonresidents.<sup>1</sup>

10. The **CBT's reserve assets** are the foreign assets immediately available and under the CBT control, as defined in the fifth edition of the IMF *Balance of Payments Manual*. They include gold, SDR assets, reserve position at the IMF, convertible foreign currencies, liquid balances held outside Tunisia, and negotiable foreign securities and bills purchased and discounted.

11. The **CBT's liabilities in foreign currency** to nonresidents include any commitment to sell foreign currencies associated with financial derivative transactions (such as swaps, futures, options), any portion of the CBT's assets (gold, for example) used as collateral, IMF and Arab Monetary Fund (AMF) credits outstanding, and deposits at the CBT of international organizations, foreign governments, and foreign bank and nonbank institutions. The government's foreign currency deposits at the CBT are not included in the liabilities, nor is any SDR allocation received after May 15, 2013.

12. All debt instruments issued in foreign currency by the CBT on behalf of the government before May 15, 2013 are also excluded as liabilities of the CBT. All debt instruments issued in foreign currency by the CBT on behalf of the government after May 15, 2013 will be treated as **CBT liabilities**, unless the offering documents (prospectus) state clearly that (i) the CBT is acting as an agent to execute all sovereign debt instruments issued in foreign currency raised through the international markets for general budgetary purposes of the Republic of Tunisia (ii) debt is a liability

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<sup>1</sup> Deposits of residents in foreign currency (excluding government deposits) at the CBT are a form of external liability of the CBT; for operational and accounting purposes, and because of legal considerations related to the regulation of foreign exchange, the CBT includes residents' foreign currency deposits in the monetary base. To preserve the accounting consistency of the CBT's accounts and be in line with the standard definition of NIR within the framework of IMF stand-by arrangements, it is agreed: (i) to retain the accounting definition of external liabilities used in the CBT balance at December 31, 2012; (ii) to adopt the principle of adjusting NIR (in the opposite direction of the net domestic assets of the CBT) on the basis of the variation in the residents' deposits in foreign currency from end-December of the previous year. It also agreed that the residents' deposits in foreign currency at the CBT include the following components of reserve money: intervention/monetary market in foreign currency, foreign currency of aggregate intermediaries, non-negotiable placement of foreign currencies, and all other items of deposits in foreign currencies created or included in reserve money. At end-December 2013, the value of the stock of deposits in foreign currencies of residents at the CBT was \$1,852.07 million at the program exchange rate.

of the central government; and (iii) a protocol between the CBT and the Ministry of Finance provides clearly that the CBT is authorized to pay all expenses and costs pertaining to the implementation of this issue as well as the interest and principal of the issue sum through direct deduction from the Treasury's current account established in the CBT's books.

**13.** The value of CBT reserve assets and liabilities in foreign currency will be calculated using program exchange rates (see Table above). On December 31, 2012, the value of the stock of net international reserves was \$7.937 billion, with the stock of reserve assets equal to \$8.645 billion and the stock of CBT liabilities in foreign currency equal to \$730.399 million (at program rates).

#### **D. Ceiling on Net Domestic Assets**

**14.** The **CBT's net domestic assets** are defined as the difference between the monetary base and the net foreign assets of the CBT.

**15.** The **monetary base** includes: (i) fiduciary money (money in circulation outside the banks and cash balances of commercial banks); (ii) deposits of commercial banks at the central bank (including foreign currency and deposit facility); and (iii) deposits of all other sectors at the central bank (i.e., other financial enterprises, households, and companies).

**16.** The **CBT's net foreign assets** are defined as the difference between the CBT's gross foreign assets, including foreign assets that are not part of the reserve assets, and all foreign liabilities of the CBT. Net foreign assets are valued at the program exchange rate defined in the above table.

#### **E. Floor on the Primary Balance of the Central Government (Excluding Grants)**

**17.** Under the program, the **primary fiscal balance of the central government (excluding grants, on a cash basis)** is measured on a financing basis and will be the negative sum of: (i) total net external financing; (ii) privatization receipts; (iii) net domestic bank financing; (iv) net domestic nonbank financing; *plus* (v) interest on domestic and external debt paid by the central government and *less* external budgetary grants received by the central government.

**18.** **Total net external financing** is defined as net external loans of the government, that is: new loan disbursements, *less* repayments of the principal. Project and budgetary loans of the central government are included, as well as any form of debt used to finance central government operations.

**19.** **Privatization receipts** are the government receipts from the sale of any government asset. This includes revenues from the sale of government shares in public and private enterprises, sales of nonfinancial assets, sales of licenses, and the sale of confiscated assets, excluding the confiscation of bank accounts. For the adjustor in NIR (see below), only receipts in foreign currency are included.

**20.** **Net domestic bank financing of the central government** is the sum of: the change in net bank loans to the central government (in Tunisian dinars and foreign currency) and the change in

central government deposits at the CBT (this includes all central government accounts at the CBT, in particular (i) Treasury current account; (ii) Tunisian government account (miscellaneous dinar accounts); (iii) loan accounts; (iv) grant accounts; (v) FONAPRA-FOPRODI accounts; (vi) special account of Tunisian government in foreign currency; (vii) current accounts of paying U.S. Treasury; (viii) accounts in foreign currency pending adjustment (subaccount: available); (ix) and any other account that may be opened by the central government at the CBT. Following the unification of government accounts at the CBT into a Single Treasury Account, government accounts are consolidated in two categories (“Compte Central du Government” and “Comptes Spéciaux du Government”) on the CBT’s balance sheet (liabilities side).

**21. Net government borrowing from the banking system** is defined as the change in the stock of government securities (Treasury bills and bonds) held by banks and any other central government borrowing from banks, less repayments. The stock of nonnegotiable bonds issued to banks during the recapitalization of public banks, and which are serviced entirely by the government, is excluded from bank claims on the government.

**22. Net domestic nonbank financing** includes: the change in the stock of government securities (Treasury bills and bonds) held by nonbanks (including social security funds) and any other central government borrowing from nonbanks, less repayments. Total Treasury bills and other public debt instruments to be taken into consideration are calculated at the nominal/face value shown on the institutions’ balance sheet and does not include accrued interest.

#### F. Ceiling on the Accumulation of External Arrears

**23. Arrears on external debt payment** are defined as late payments (principal and interest) on external debt or guarantees as defined in *External Debt Statistics: Guide for compilers*<sup>2</sup> by the central government or the CBT after 90 days from the due date or the expiration of the applicable grace period.

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<sup>2</sup> The definition of debt set forth in *External Debt Statistics: Guide for Compilers* reads as the outstanding amount of those actual current, and not contingent, liabilities, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to nonresidents by residents of an economy. Debts owed to nonresidents can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers’ credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property.

## G. Indicative Ceiling on the Accumulation of Domestic Arrears

24. For program purposes, arrears on **domestic debt payment** are defined as amounts owed to domestic financial and commercial creditors that are 90 days or more overdue with respect to a specific maturity date (or as defined in the contractual grace period, if any). If no maturity date is specified, arrears are defined as amounts owed to domestic creditors that remain unpaid 90 days or more after the date on which the contract was signed or upon receipt of the invoice.

## H. Indicative Ceiling on Central Government Primary Current Expenditure (excluding Interest Payments on Public Debt)

25. Under the program, central government primary current expenditure is defined as the sum of central government expenditure on: (i) personnel wages and salaries; (ii) goods and services; (iii) transfers and subsidies; (iv) other unallocated current expenditure.<sup>3</sup>

## I. Indicative Floor on Social Expenditures

26. Social **expenditures** are defined as capital expenditures (development expenditures) on education, health, social transfers to needy families, the AMEL employment training program (and university scholarships), UTSS indemnities, family allocation as well as development expenditures of the Ministry of Women and Family Affairs, Youth and Sports and Social Affairs; all current expenditures ("dépenses de gestion") of the above-mentioned sectors and programs, as well as food and energy subsidies, are excluded.

## J. Adjustment Factors for the Program Performance Criteria

27. The **NIR** targets are adjusted upward (downward) if the cumulative sum of net external financing of the central government (excluding project loans and any access to capital markets), the sum of budgetary grants, privatization receipts received in foreign currency, the increase (decrease) in the residents' foreign currency deposits at the CBT are greater (lower) than the levels observed at end December 2013. The NIR targets will be also adjusted upward (downward) if the total amount of cash payments on external debt service of the government is greater (lower) than the levels included in the table above.

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<sup>3</sup> The methodologies used to measure current expenditure categories for the central government are those used to design the table of central government financial operations presented in the macroeconomic framework.

**Program Assumptions on Adjustment Factors for Quantitative Performance Criteria**

(Millions of US dollars)

	2014		2015				
	2014 Q4	Year	2015 Q1	2015 Q2	2015 Q3	2015 Q4	Year
Government External Financing	929.0	3,058.3	1,223.3	511.5	504.7	581.6	2,821.0
Project loans	84.5	256.3	30.0	50.0	110.0	110.0	300.0
Multilateral donors	278.1	1,479.9	957.1	338.4	200.0	400.0	1,895.4
AFDB	0.0	0.0	0.0	0.0	200.0	0.0	200.0
AMF (Arab Monetary Fund)	41.5	41.5	0.0	0.0	0.0	0.0	0.0
IMF (budget support)	110.1	1,061.9	329.7	219.8	0.0	0.0	549.5
World Bank Group	0.0	250.0	500.0	0.0	0.0	400.0	900.0
European Union	126.5	126.5	127.4	118.6	0.0	0.0	245.9
Bilateral donors	100.0	300.0	0.0	0.0	0.0	0.0	0.0
Algeria Budget support	100.0	100.0	0.0	0.0	0.0	0.0	0.0
Turkish loan	0.0	200.0	0.0	0.0	0.0	0.0	0.0
Financial Market Access and other	466.4	1,022.1	236.2	123.1	194.7	71.6	625.6
Sukuk and other market financing	0.0	0.0	226.2	113.1	169.7	56.6	565.6
Market issuance with Japanese guarantee	463.7	463.7	0.0	0.0	0.0	0.0	0.0
Market issuance with US Treasury guarantee	0.0	500.0	0.0	0.0	0.0	0.0	0.0
Loan Transfers to SOEs	2.7	58.4	10.0	10.0	25.0	15.0	60.0
Budget Grant	92.0	165.6	0.5	0.0	58.5	76.7	135.6
Privatization Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government External Debt Service	239.1	945.9	229.6	329.6	221.9	277.4	1,058.5
Amortization	177.6	604.7	142.7	234.5	140.5	221.2	738.9
Interest	61.4	341.2	86.9	95.1	81.4	56.2	319.6
Resident deposits at the BCT 1/							

Sources: Tunisian authorities and IMF staff estimates.

1/ End December 2013 is the reference level and was estimated at USD 1,852.07 million.

**28.** The net **domestic assets (NDA)** targets will be adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the cumulative sum of net external financing of the central government (excluding project loans and any access to capital markets), the sum of budgetary grants, privatization receipts received in foreign currency, the increase (decrease) in residents' foreign currency deposits at the CBT are lower (greater) than the levels indicated in the following table. The NDA targets are also adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the total amount of cash payments on external debt service are greater (lower) than the levels included in the table below. The NDA ceiling will be converted into Tunisian dinars at the program exchange rate.

**29.** The ceilings on the **NDA of the CBT** will also be adjusted downward or upward based on the amount of CBT reserves released/mobilized because of a possible decrease/increase in the reserve requirement.

**30.** The floor on the **primary balance of the central government**, excluding grants, will be adjusted upward/downward based on the amount used to recapitalize and restructure the public banks. The amounts for the last quarter of 2014 and first quarter of 2015 are assumed to be zero.

## **K. Monitoring and Reporting Requirements**

**31.** Performance under the program will be monitored using data supplied to the IMF by the Tunisian authorities as outlined in the table below, consistent with the program definitions above. The authorities will promptly transmit to the IMF staff any data revisions.

## Information to be Reported in the Context of the Program

<b>Type of Data and Description</b>	<b>Periodicity</b> <i>Weekly (w)</i> <i>Monthly (m)</i> <i>Quarterly (q)</i>	<b>Delay in days</b>
<b>GDP:</b> Supply and demand at current, constant, and the previous year's prices, including sectoral indices.	<i>q</i>	45
<b>Inflation:</b> Including the underlying inflation of non-administered and administered prices.	<i>m</i>	14
<b>Fiscal Sector</b>		
<b>Tax and nontax revenue of the central government decomposed on the basis of main tax and nontax revenues items</b>	<i>m</i>	30
<b>Total expenditures:</b> current and capital, transfers and subsidies.	<i>m</i>	30
<b>Capital expenditure:</b> by type of financing: domestic and external (differentiating loans and grants), and by main sectors and projects (agriculture, social, infrastructure).	<i>m</i>	45
<b>Current expenditure:</b> by type of expenditure: wages, goods and services, transfers.	<i>m</i>	45
<b>Social expenditure</b>	<i>q</i>	45
<b>Domestic and foreign debt</b>		
<b>Stock of domestic and foreign debt:</b> of the central government and debt guaranteed by the government, with breakdown by instrument and type of currency (in dinars and foreign currency with the equivalent in domestic currency).	<i>q</i>	30
<b>Stock of domestic arrears</b> as per TMU, as well the stock of accounts payable that correspond to expenditures committed/ payment ordered more than 90 days before (and by type of expenditures),	<i>q</i>	45
<b>Disbursement of foreign loans:</b> Breakdown into project loans and budgetary loans by principal donor and identifying the most important projects to be financed in the original currency and its equivalent in Tunisian dinars converted at the current exchange rate at the time of each transaction.	<i>m</i>	30
<b>Domestic borrowing from banks and nonbanks:</b> including bonds, Treasury bills, and other issued securities.		

<b>Debt guaranteed by the government: by instrument and type of currency (in dinars and in foreign currencies and its equivalent in national currency)</b> <b>External and domestic debt service:</b> amortization and interest.	<i>m</i>	60
<b>External payment arrears:</b> external debt contracted and guaranteed by the government.	<i>q</i>	30
<b>Debt rescheduling:</b> possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	<i>q</i>	45
<b>Consolidated accounts of the central government at the CBT:</b> The stock of deposits will be broken down as follows: (i) Treasury current account; (ii) special account of the Tunisian government in foreign currency and its equivalent in dinars; (iii) miscellaneous dinar accounts; (iv) loan accounts; (v) grant accounts; (vi) FONAPRA-FOPRODI accounts; and (vii) accounts pending adjustment (including privatization receipts from Tunisia Telecom).	<i>m</i>	30
<b>External Sector</b>		
<b>Imports of Petroleum Products:</b> average import price of main petroleum products.	<i>m</i>	30
<b>Foreign trade:</b> imports and exports of goods, including volumes and prices, by sector.	<i>m</i>	30
<b>Deposits:</b> Stock of foreign currency deposits, according to the residence of the holder.	<i>m</i>	14
<b>External debt:</b>	<i>q</i>	30
Debt service (amortization and interest) of institutional agents by instrument and at type of currency (in foreign currency and its equivalent in dinars).	<i>m</i>	30
Stock of external debt of institutional agents by instrument and type of currency (in foreign currency and its equivalent in dinars) (in conformity with our obligations under SDDS).	<i>q</i>	90
Overall net external position of Tunisia (preliminary).	<i>q</i>	90
Overall gross external debt position	<i>q</i>	90
Overall net external position of Tunisia (in conformity with our obligations under SDDS).	<i>A</i>	180
<b>Balance of payments:</b> Prepared by the CBT	<i>q</i>	30



<b>Monetary and Financial Sector</b>		
<b>CBT accounts at the current exchange rate:</b> detailed table including the monetary system.	<i>m</i>	30
<b>CBT accounts at the program exchange rate: Including net international reserves.</b>	<i>m</i>	30
<b>Foreign exchange market operations, Interbank market, retail market and wire transfers for CBT purchases on the retail market:</b> CBT spot sales and purchases on the foreign exchange market, , stock of CBT currency swap (provide details on direction of transactions (TND/FX or FX/TND), amounts of principal, spot exchange rate in swaps agreement, interest rate applied on FX counterpart), detailed information on other BCT's forward foreign exchange operations, including outright forward sales of Tunisian Dinar. The terms and conditions of any new transactions (including the extension or renewal of existing terms and conditions) will also be provided. CBT foreign exchange reserves, breakdown by currency and by instrument, and the institutions where such reserves are held.	<i>m</i>	30
<b>Banks' financial soundness ratios:</b> Indicators of financial soundness and regulatory capital adequacy ratios of the banking system, including the quality of assets and the profitability of banks. The indication of the different banks is optional.	<i>m</i>	30
<b>Direct refinancing of commercial banks by the CBT:</b> Breakdown by bank.	<i>m</i>	14
<b>Interest rates:</b> Deposit rates, interbank rates, and lending rates.	<i>w</i>	14
<b>NPLs:</b> Stock of banking sector NPLs, and breakdown by commercial banks.	<i>q</i>	60
<b>Balance sheets of commercial banks,</b> including detailed income statements, in accordance with "Uniform Bank Performance Reporting" agreed with Fund staff.	<i>q</i>	60
<b>Other information to be reported</b>		
<b>Information on Fiscal, Monetary, and Financial Policy:</b> Decrees or circulars newly adopted or revised concerning changes in tax policy, tax administration, foreign exchange market regulations, and banking regulations. A copy of official notices of changes in gas and electricity rates and any other surcharge (automatic or structural), as well as the prices of petroleum products and levies/surcharges on gas and petroleum.	<i>d</i>	3