February 2001
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Tunisia: 2000 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2000 Article IV consultation with Tunisia, the following documents have been released and are included in this package:

- the staff report for the 2000 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 30, 2000, with the officials of Tunisia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on January 19, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of February 7, 2001, updating information on recent economic and policy developments.

- the Public Information Notice (PIN), which summarizes the **views of the Executive Board as expressed during its February 7, 2001 discussion** of the staff report that concluded the Article IV consultation.

The document(s) listed below have been or will be separately released.

- a staff report supplement of January 29, 2001, updating the Report on the Observance of Standards and Codes

- Statistical Appendix

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

TUNISIA

Staff Report for the 2000 Article IV Consultation

Prepared by the Staff Representatives for the 2000 Consultation with Tunisia

Approved by Abdelali Jbili and Masood Ahmed

January 19, 2001

- Discussions for the 2000 Article IV consultation were held in Tunis during October 18-30, 2000. The staff team included Mr. Gardner (head), Ms. Laframboise, Mr. Martin and Ms. Jaumotte (all MED). The mission coordinated in the field with STA technical assistance missions and with a World Bank mission discussing ongoing and future adjustment lending.
- The mission met with Governor Hamda (Central Bank of Tunisia), Minister Baccar (Finance), Minister Saddam (Economic Development), Minister Ben Abdallah (Industry), Minister Maouïa (Tourism, Leisure and Artisanat), Minister Merdassi (International Cooperation and Foreign Investment), Minister Neffati (Social Affairs), Minister Rabah (Agriculture), Minister Rouissi (Employment and Training), Minister Znaidi (Commerce). The staff also met with public officials from various ministries and with representatives of the banking and financial sector. Mr. Rouai, Advisor to the Executive Director, participated in all the meetings.
- At the conclusion of the last Article IV consultation on September 2, 1999, Executive Directors commended the authorities' prudent and consistent macroeconomic policies, Tunisia's steady and strong growth performance, and the positive role played by the medium-term orientation of policies. Directors encouraged the authorities to lower trade barriers further and to accelerate privatization and price liberalization in order to enhance productivity and competitiveness and raise potential growth. Directors supported the authorities' flexible use of exchange rate policy to preserve competitiveness.
- Tunisia has agreed to participate in a Financial Sector Assessment Program/Financial System Stability Assessment (FSAP/FSSA) in April/May 2001. The authorities published the preliminary conclusions of the 2000 Article IV mission on October 29, 2000 (www.imf.org\external\country\TUN\index.htm) and have agreed to publish the staff report.
- Tunisia accepted the obligations of Article VIII, Sections 2-4 in January 1993. Tunisia maintains multiple currency practices from prior commitments which will expire in 2001.
- The principal author of this report is Mr. Edward Gardner.

Contents

Appendices

Glossary

AAEU	Association Agreement with the European Union
BH	Banque de l'Habitat
BTAs	Bons du Trésor assimilables
BTCs	Bons du Trésor cessibles
BTCTs	Bons du Trésor à court terme
CPI	Consumer price index
EFF	Extended Fund Facility
EU	European Union
FDI	Foreign direct investment
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
MCP	Multiple currency practices
MFN	Most-favored-nation
NTB	Non-tariff barriers
SDDS	Special Data Dissemination Standard
SMEs	Small and medium-sized enterprises
TFP	Total factor productivity
WTO	World Trade Organization

Executive Summary

- Real growth strengthened to an average rate of 5.2 percent over the last five years, as gradual liberalization and prudent macroeconomic policies allowed Tunisia to reap the benefits offered by stronger integration into the world economy. Despite significant job creation, high labor force growth has caused the unemployment rate to remain roughly unchanged over this period at around 15 percent. Progress has been achieved in developing the private sector, but much remains to be done to liberalize the economy.

- Real GDP growth of 5 percent is expected for 2000, despite the effects of drought on agricultural output. Annual inflation remains stable at around 3 percent. The budget deficit in 2000 is estimated at around 3.4 percent of GDP (excluding privatization proceeds and grants; 2.9 percent including the social security surplus), down from 3.9 percent in 1999. Thanks in part to large privatization proceeds (1.3 percent of GDP), government debt is set to decline to 54 percent of GDP in 2000. Structural reforms have proceeded on several fronts, including banking sector reform and enterprise restructuring, but more thorough efforts are needed to liberalize prices and external trade, and open the economy to private sector activity.

- In the face of a weakening euro, the central bank departed from its fixed real exchange rate rule during 2000, allowing the dinar to depreciate somewhat in real effective terms. A rising investment rate was reflected in a widening of the external current account deficit to an estimated 3.2 percent of GDP. Strong foreign direct investment (FDI) inflows linked to privatization limited the external borrowing requirement, and total external debt should decline to 57 percent of GDP in 2000. Tunisia's credit rating was upgraded in 2000, and the authorities tapped markets at much improved terms compared to 1999.

- In view of the relatively strong outlook for 2001, policy discussions focused on medium-term prospects and the prerequisites for moving to a higher growth path. This will require faster and deeper liberalization of the economy (full implementation of the privatization drive launched for 2001 and an accelerated pace of trade and price liberalization), a strengthening of the credit culture (improved corporate transparency and opening of public banks to foreign capital to improve risk management), and increased labor market flexibility.

- Macroeconomic policies for the medium-term should include a sustained path of budget deficit reduction to counter pressures on the external accounts and on the social security accounts. This will require dealing with budgetary rigidities stemming from the high wage bill and extensive tax exemptions. The gradual strengthening of the banking sector and the development of the bond market should gradually allow interest rates to play a stronger role in credit allocation. In the context of trade liberalization with the European Union (EU), exchange rate policy should be guided by a broader set of competitiveness indicators than simply relative consumer price indices (CPIs).

- The authorities have made a notable effort to increase the transparency of policies, including by committing to subscribe to the Special Data Dissemination Standard (SDDS) (by mid-2001), publishing the preliminary conclusions of the Article IV mission, and agreeing to publish this staff report. They have also agreed to participate in an FSAP/FSSA in 2001.

I. BACKGROUND

1. **Growth has strengthened to an average rate of 5.2 percent over the last five years**, as gradual liberalization, in a context of macroeconomic stability, has allowed Tunisia to capitalize on the opportunities offered by stronger integration in the world economy (Charts 1 and 2). Supported by more liberal exchange, trade and regulatory regimes, private sector activity has developed rapidly in the export and tourism sectors, while domestic demand growth has been buoyed by rising real incomes. The fixed investment rate has averaged 25 percent of GDP through the 1990s. Investment in the services and export-oriented manufacturing sectors has been particularly strong. Investment in housing has been equally buoyant, sustained by high demand for home ownership—80 percent of households own their own home (see Box 1). GDP growth has been strong in all sectors, particularly services and manufacturing, and the share of the primary sector (agriculture and fishing) in GDP has declined only marginally over the last 10 years, from 16 percent to 14 percent. Over the same period, the share of hydrocarbon production in GDP has come down from 6 percent to 4 percent.

2. **High labor force growth has caused the unemployment rate to remain roughly unchanged at around 15 percent**, despite significant job creation (2.6 percent growth per year over the last five years). The decline in population growth from 2.5 percent per year in the 1980s to 1.4 percent per year in the last five years will translate into lower labor force growth over the medium-term. Much of recent GDP growth has come from high labor productivity growth (Chart 3). Employment growth accounted for roughly 15 percent of total GDP growth since 1994, compared to 35 percent for human capital, 30 percent for physical capital and 20 percent for total factor productivity (TFP).[1]

3. **Tunisia's successful economic performance rests on well-coordinated macroeconomic, social and structural policies**, and in particular on a three-pronged strategy of: (i) prudent macroeconomic policies, grounded in a medium-term framework; (ii) progressive social policies that are reflected in a significant accumulation of human capital; and (iii) steady, if at times hesitant, opening and liberalization of the economy. In addition to raising growth, this approach has contributed to improved social indicators and income distribution (poverty incidence declined from 13 percent in 1980 to 6 percent in 1995).[2]

4. **Price stability has been attained through an active incomes policy backed by prudent financial policies, while the exchange rate has been assigned to preserving external competitiveness.** Limited capital mobility (beyond FDI flows) has made it possible to pursue independent monetary and exchange rate objectives. Sector-wide wages are set through three-yearly national negotiations involving the social partners and the government—current agreements, negotiated in 1999 and due to expire at the end of 2001, provide for average annual wage increases of around 4.5 percent. This approach has contributed to price and social stability, all the while ensuring external viability. However, it has greatly limited wage flexibility and dispersion across enterprises.

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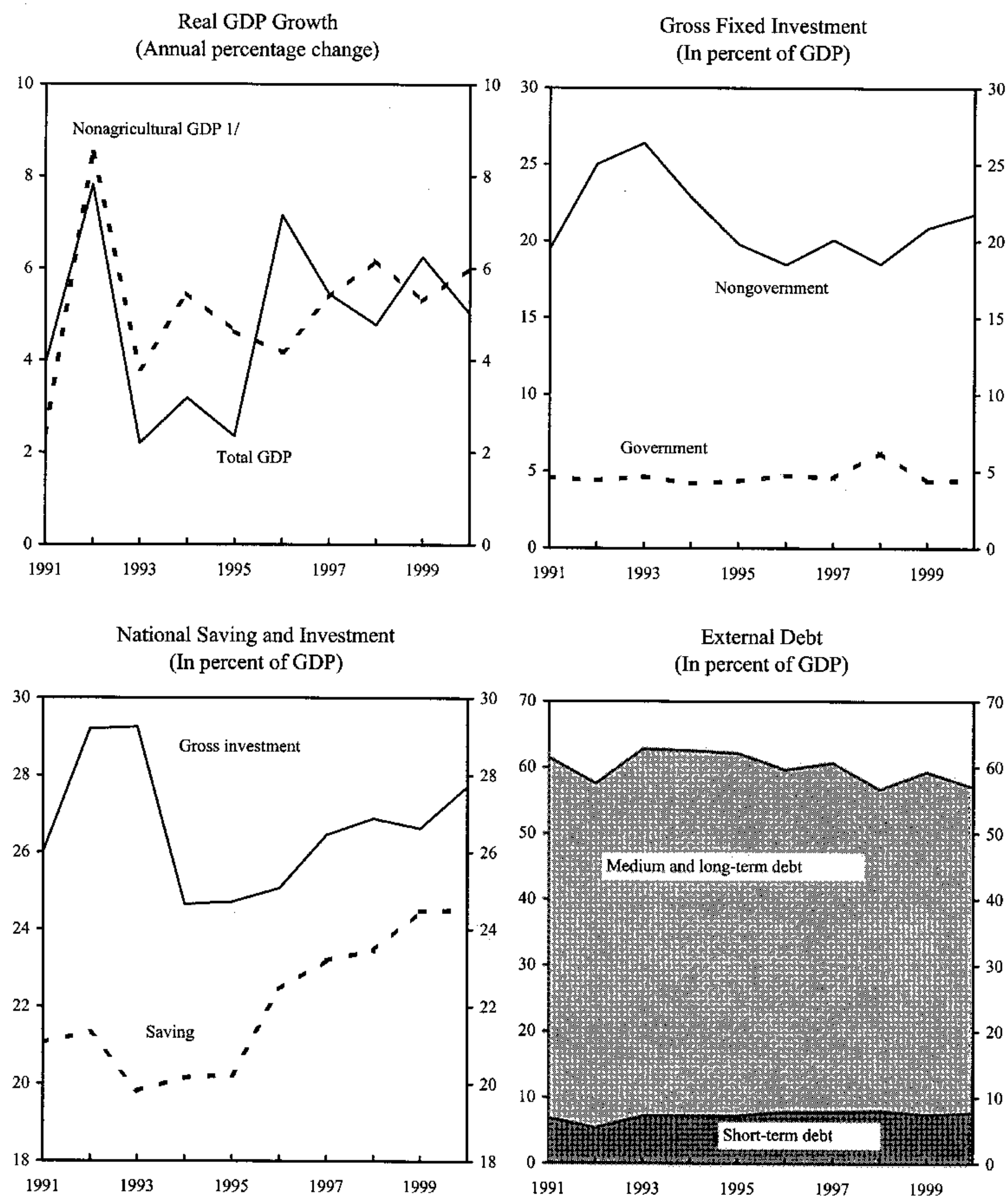
[1] Based on the production function described in Box 2.

[2] Poverty incidence headcount index, Tunisian National Statistical Institute.

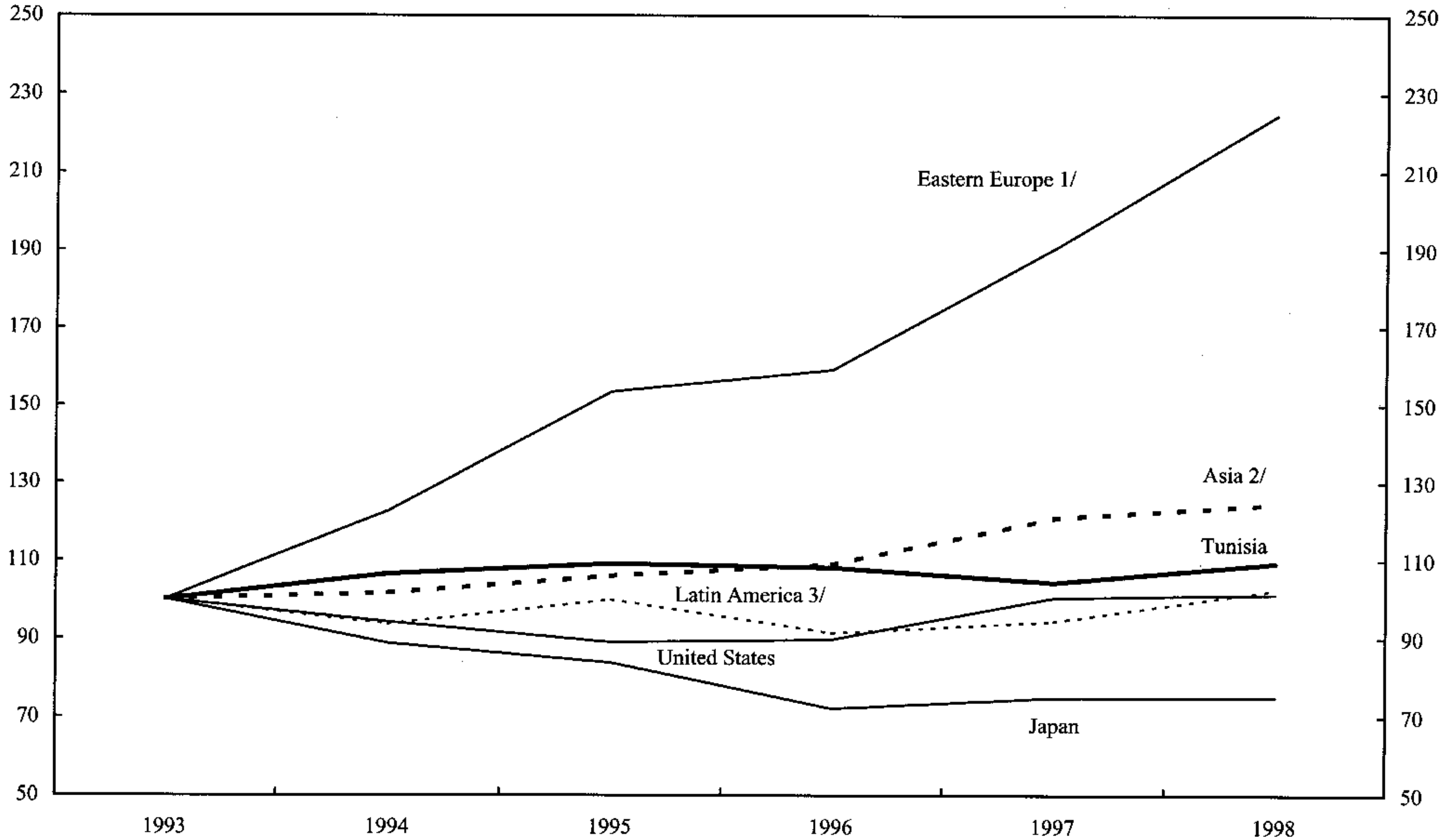
Chart 1. Tunisia: Main Economic Indicators, 1991–2000



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

1/ Excludes also fisheries and food processing.

Chart 2. Tunisia: Export Market Shares of Manufactured Goods to the EU, 1993–98
(Index 1993=100)



Source: United Nations, TARS.

1/ Czech Republic, Slovak Republic, Bulgaria, Hungary, Poland, Romania.
2/ China, China P.R.Taiwan, China P.R. Hong Kong, India, Indonesia, Korea, Malaysia, Philippines, Singapore,Thailand.
3/ Argentina, Brazil, Chile, Mexico.

Box 1. Tunisia Housing Policies

Home ownership in Tunisia is high—78 percent of households in 1999, about the same level as in 1984—and quite evenly distributed across income levels: the home ownership rate of the wealthiest decile of the population was only about 10 percentage points higher than that of the poorest decile (1995). Underlying these results is a steady rate of investment (4 percent of GDP since 1990) that has resulted in 3.5 percent average annual increase in the number of housing units since 1984.

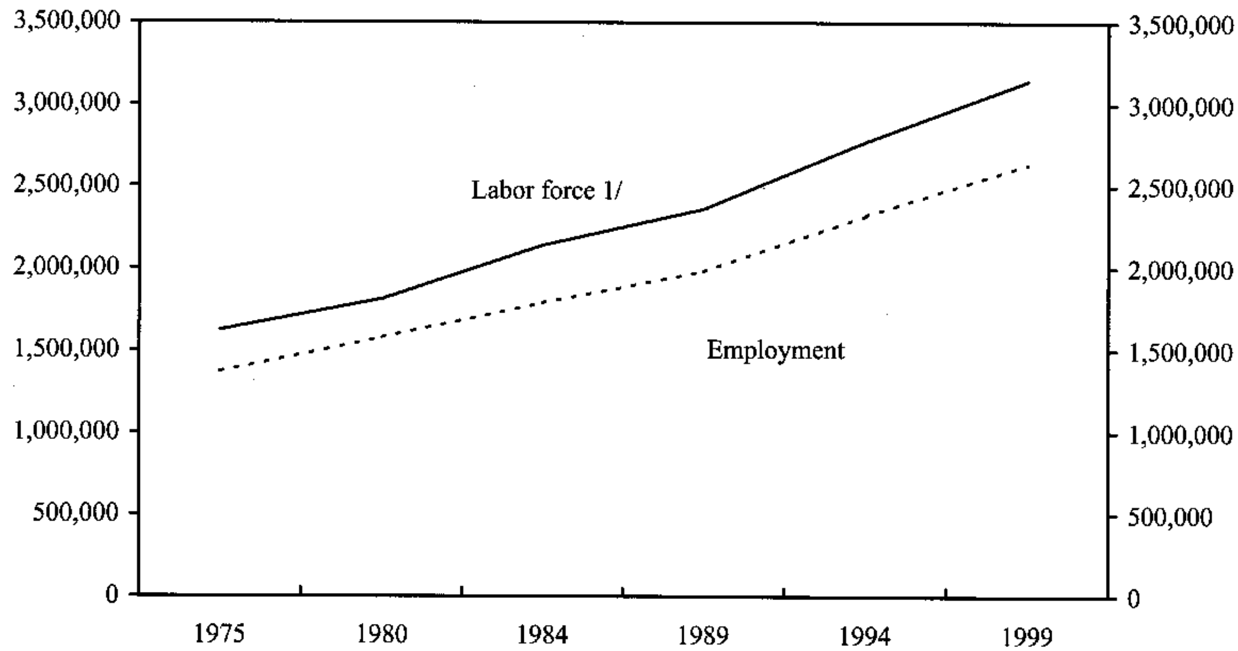
Three forces appear to be behind the high rate of home ownership: i) a longstanding social and cultural tradition of home ownership; ii) a system of incentives for saving and investment; and iii) access to financing from the banking system at preferential rates.

Tax incentives in favor of housing construction include: the deductibility of earnings reinvested in real estate/land development, a 50 percent deductibility of revenues earned by real estate companies on infrastructure and equipment projects in specific areas, and a 50 percent deductibility of revenues earned on "social housing." Rental income on "social or economic" housing is also deductible for ten years after construction, provided the property remains in the hands of the developer.

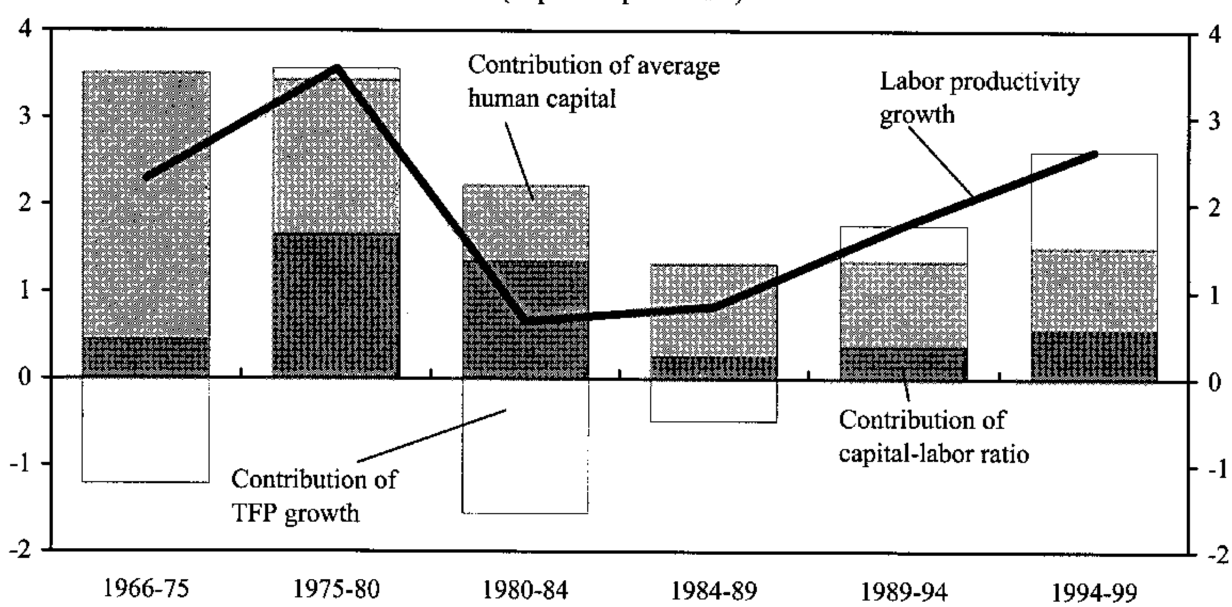
Financing is provided under four main schemes: (1) subsidized credit (*Fonds de Promotion du Logement pour les Salarié* (FOPROLOS)) at a rate of 3.5 percent-5.0 percent for households earning less than three times the minimum wage; (2) credit linked to tax-free savings accounts (*plan épargne logement*) allowing the saver to borrow up to three times the level of accumulated savings at an interest rate of 6.75 percent; (3) traditional mortgage lending at spreads of 1 percent-3 percent over the money market rate (5.875 percent), with the lower spread applying to cheaper housing; and (4) lending by the social security funds. In 1999, new lending was equivalent to 1.6 percent of GDP: FOPROLOS accounted for 7 percent of new lending, the *plan épargne logement* for 17 percent, mortgage lending for 72 percent, and the social security funds for 4 percent.

The state-owned *Banque de l'Habitat* (BH) administers all of the subsidized programs (including the *plan épargne logement*) and provides the bulk of mortgage lending. In all, it accounts for 80 percent of housing lending. Stable housing prices (allegedly rising at a slightly faster rate than the CPI) and strong income growth have resulted in very low default rates, and despite the low margins applied on some of its housing credits, the BH has been quite profitable in recent years. That being said, the BH holds a competitive advantage over other banks by virtue of its exclusive rights to administer the state subsidy program and the *plan épargne logement*.

Chart 3. Tunisia: Labor Market Developments, 1966-1999



Sources of Labor Productivity Growth
(In percent per annum)



Sources: *Recensement general de la population et des logements*, 1996, 1975; *Enquete population-emploi*, 1980, 1989, 1999; *Recensement general de la population et de l'habitat*, 1984, 1994; *Institut National de la Statistique*, Tunis; World Bank; and staff estimates based on the production function described in Box 2.

1/ Labor force defined as active population of 15 years of age and above.

5. **Despite progress achieved in developing the private sector, much remains to be done to liberalize and modernize the economy.** Trade protection remains high and significant restructuring is required to fully meet the challenges of trade liberalization under the Association Agreement with the European Union (AAEU).[3] Weak lending practices and supervision resulted in the accumulation of a large stock of bad loans, which are declining but still stood at 20 percent of GDP at the end of 1999. Meanwhile, the state retains extensive control over the economy through a large public enterprise sector and through controls on prices and market access. While these rigidities do not appear to have hampered growth performance until now, they are likely to become more constraining as the domestic economy opens to foreign competition.

II. Recent Economic and Policy Developments

6. **Growth performance in 2000, and expected in 2001, confirms recent favorable trends**. Despite the drop in agricultural output in 2000 due to drought conditions, economic activity remains robust, reflecting the growing diversification of the economy. Real GDP growth is expected to reach 5 percent in 2000 (6 percent excluding agriculture) based on solid export performance and strong domestic demand. An expected rebound of agricultural activity, as well as sustained growth in domestic and foreign demand, should push GDP growth past the 6 percent mark in 2001.

7. **Inflation has remained stable at around 3 percent per annum**, despite higher food and energy prices.[4] It is projected to remain roughly unchanged in 2001. With labor productivity trending at over 2.5 percent per year, the current wage inflation of 4.5 percent should not result in additional inflationary pressures.

8. **The external current account deficit has widened to an estimated 3.2 percent of GDP in 2000** due to a combination of factors, amongst which a deterioration in agricultural trade, a slowdown in the growth of tourism receipts, a generally stronger growth of imports, in particular of raw materials and semi-finished products, and the rise in oil prices (the energy balance is slightly negative in volume terms) (Chart 4). A partial reversal of some of these trends should cause the current account deficit to narrow somewhat in 2001.

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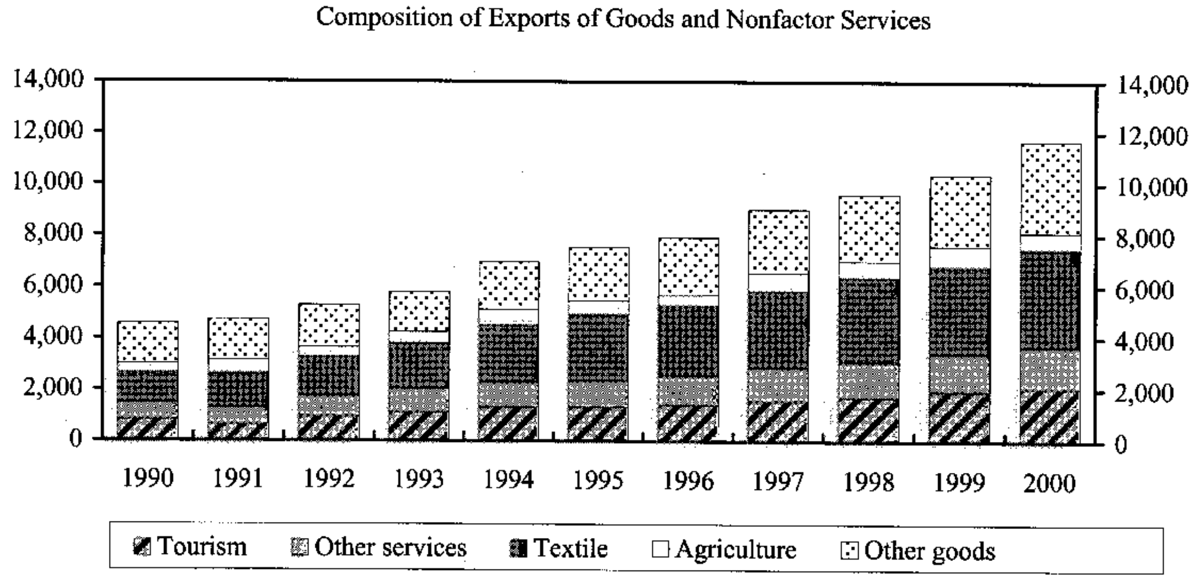
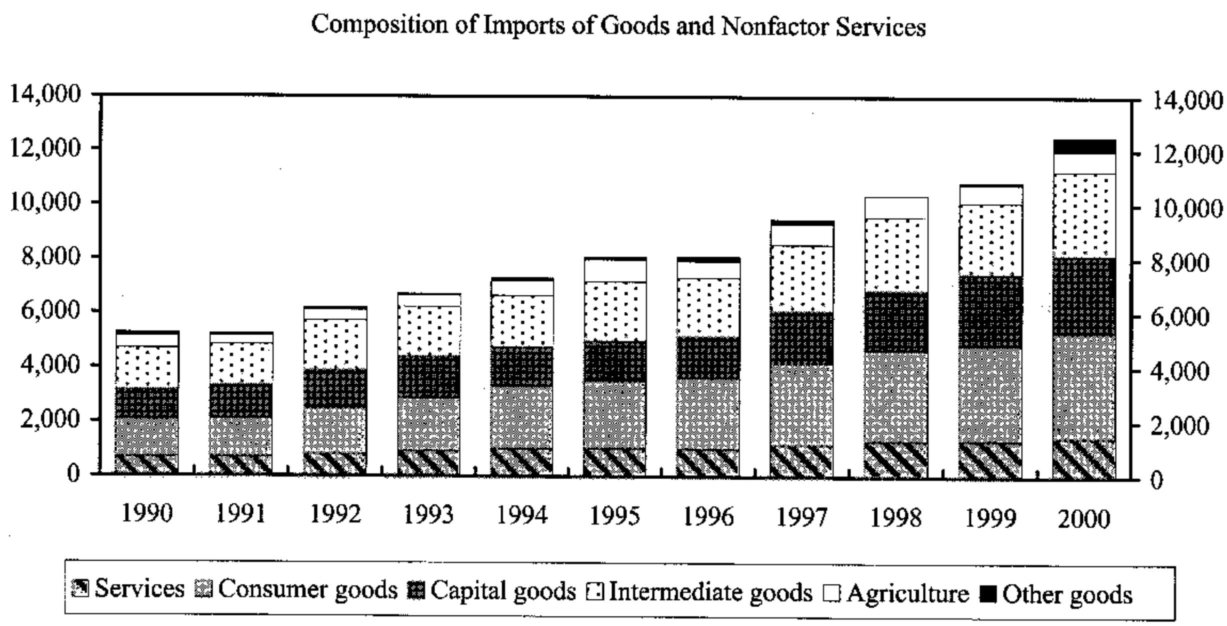
[3] The main features of the agreement are described in Box 5 of the 1999 Article IV Staff Report (SM/99/201, 8/9/99).

[4] The prices of petroleum products were raised by about 10 percent in the course of 2000, or about 1/3 of the increase implied by international prices. Following these increases, the price of unleaded gasoline stood at TD 0.71 dinar per liter (US$0.51 per liter) in September 2000, and the price of gasoil was TD 0.415 per liter (US$0.30 per liter). Current domestic prices and taxes correspond to an oil price of US$18 per barrel. The budget subsidy increases by about US$10 million (0.05 percent of GDP) for every dollar increase (per barrel) above that level.

Chart 4. Tunisia: Composition of Trade, 1990-2000
(In millions of dinars)





Source: Ministry of Economic Development.

9. **The budget deficit target set by the 2000 budget law (3.7 percent of GDP) is likely to be comfortably met,** as supplementary spending on petroleum price supports have been more than offset by higher tax revenues. The budget deficit in 2000 should thus fall to around 3.4 percent of GDP (excluding privatization proceeds and grants), down from 3.9 percent in 1999. Because of an offsetting decline in the social security surplus from the exceptionally large level registered in 1999, the consolidated fiscal deficit should increase slightly in 2000 to 2.9 percent of GDP compared to 2.6 percent in 1999 (Chart 5). As a result of higher privatization proceeds (1.3 percent of GDP compared to none in 1999), the borrowing requirement will fall to 1.7 percent of GDP. Just under half of the financing requirement will come from foreign sources and the remainder from domestic debt issues.

10. **During 1999, and to a lesser extent in 2000, the monetary authorities have had to accommodate large portfolio shifts out of liquid treasury paper into time deposits,** stemming from the phasing out of liquid treasury bills (BTCs or *bons du Trésor cessibles*) and their replacement with auctioned bills and bonds (BTAs or *bons de Trésor assimilables* and BTCTs or *bons du Trésor à court terme*).[5] This has led to a marked increase in the growth of broad money (19 percent in 1999, and 10 percent projected in 2000) and in the credit to government, as maturing paper held by the public (BTCs) was replaced by bonds acquired by banks (BTAs and BTCTs). However, no impact is expected on economic activity or interest rates since overall liquidity (M4 which includes liquid treasury bills) has increased only moderately, and in line with the authorities' target, growth in credit to the economy (private sector and public enterprises) has been kept slightly below nominal GDP growth (Chart 6).

11. **Faced with a weakening euro, the central bank departed from its fixed real exchange rate rule in the course of 2000,** allowing the dinar to depreciate by 9 percent against the U.S. dollar over the year (Chart 7). In real effective terms the exchange rate depreciated by 0.7 percent in the first ten months of 2000 (relative to the same period of 1999).

12. **Tunisia's international credit rating was upgraded in 2000,**[6] enabling it to borrow on international markets at a much lower spread (130 basis points on a 10-year yen issue) than in 1999 (280 basis points on a 10-year euro issue). By tapping international financial markets, Tunisia replenished its foreign reserves following large amortization payments in early 2000 to the target level of three months of imports. Non-debt creating capital inflows (mostly FDI) should reach US$650 million in 2000, about 40 percent of which from the privatization of the last large public cement enterprise in early 2000. Medium and long-term external debt is expected to decline from 52 percent of GDP in 1999 to 49 percent of GDP in 2000. Short-term debt stands at under 8 percent of GDP, over half of which consists of the deposits of Tunisians residing abroad and the balances of offshore companies and tour operators.

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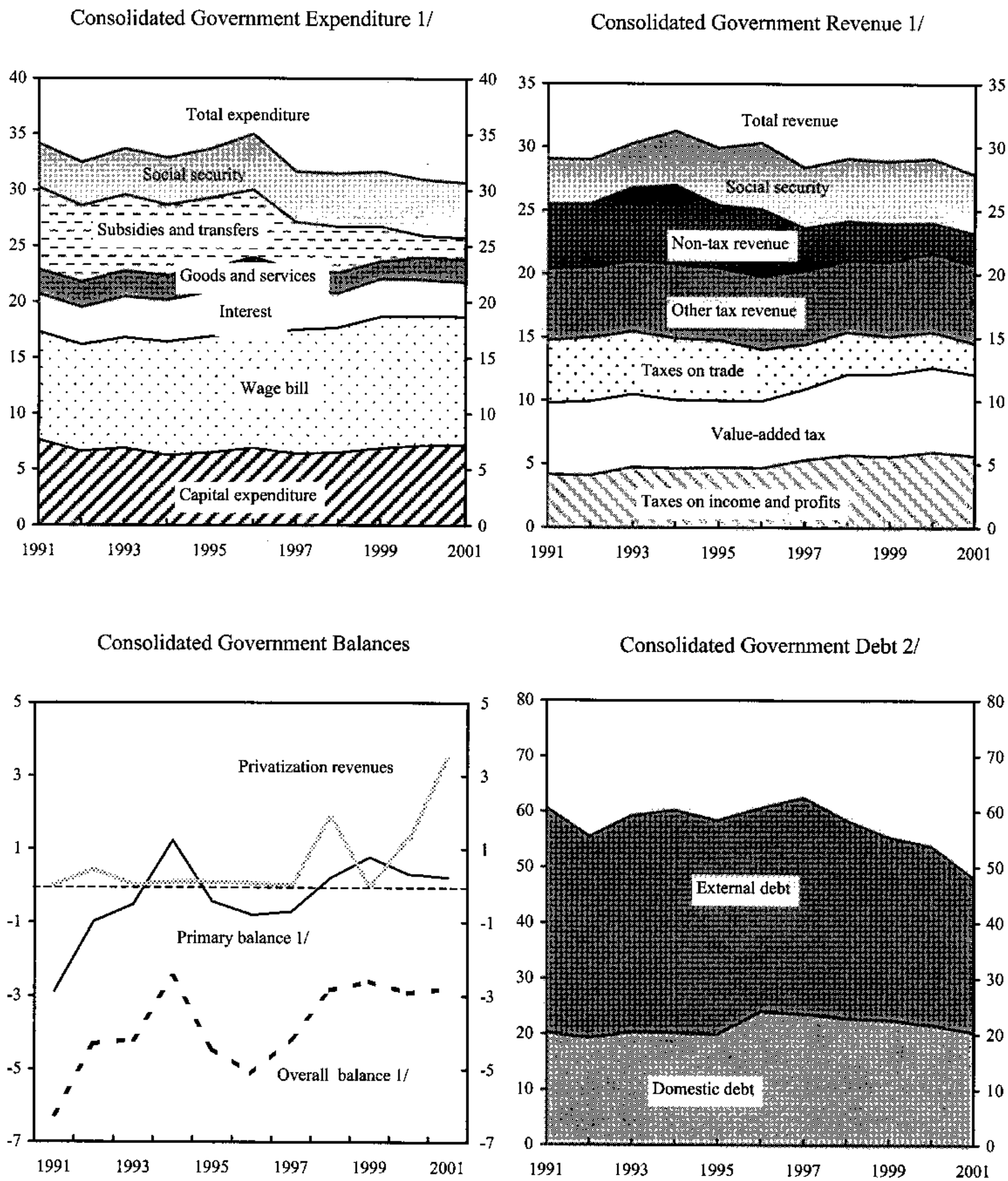
[5] In effect, the BTCs were held by the public under repurchase agreements with commercial banks, and were thus close substitutes for time deposits.

[6] Standard and Poor's long-term foreign currency rating was upgraded to BBB in March 2000. Moody's revised its outlook from "stable" to "positive" in early 2000.

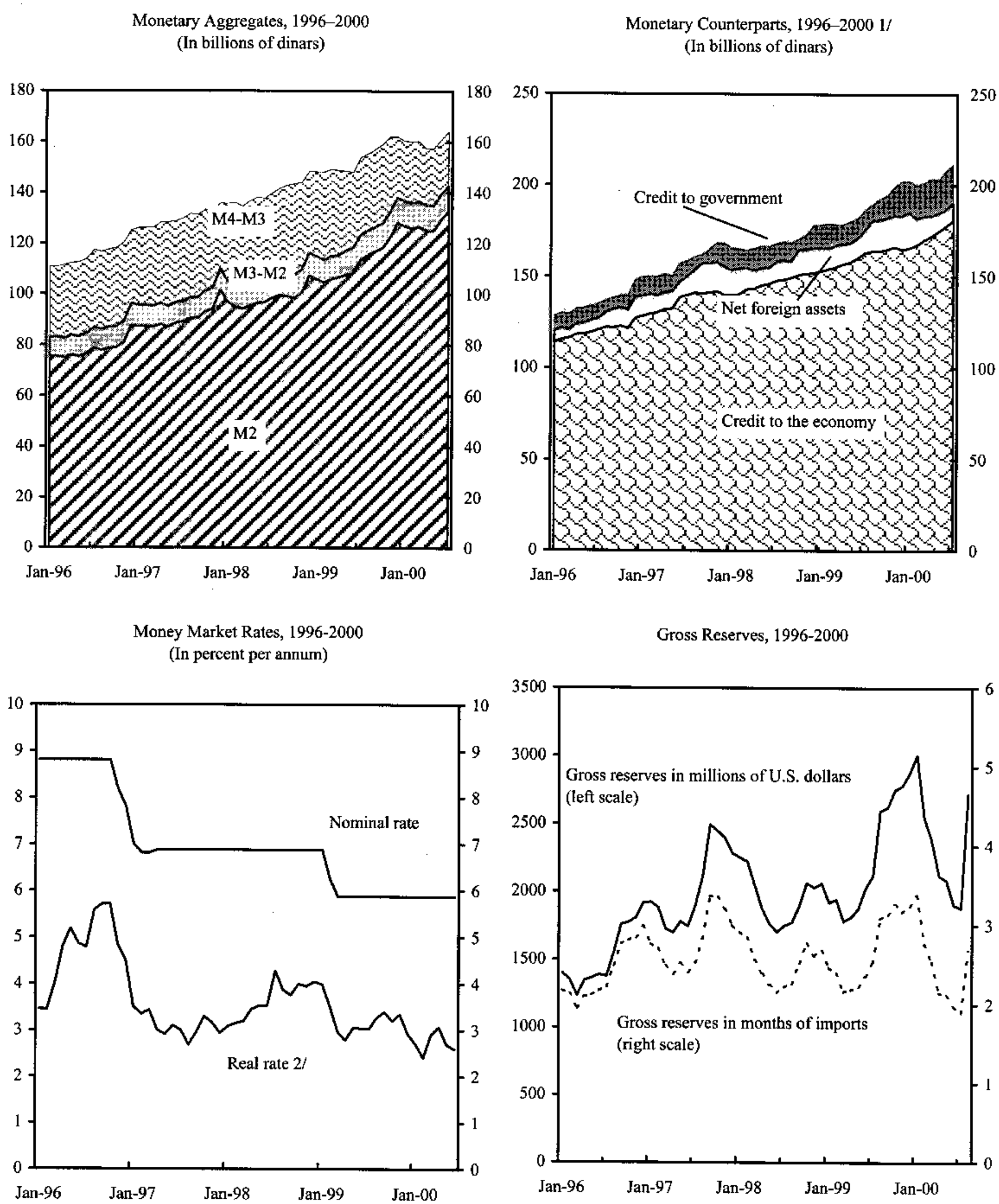
Chart 5. Tunisia: Fiscal Developments, 1991–2001
(In percent of GDP)



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

1/ Includes the social security, but excludes grants and privatization proceeds.
2/ Gross debt, including debt held by social security funds.

Chart 6. Tunisia: Monetary and Financial Indicators, 1996–2000

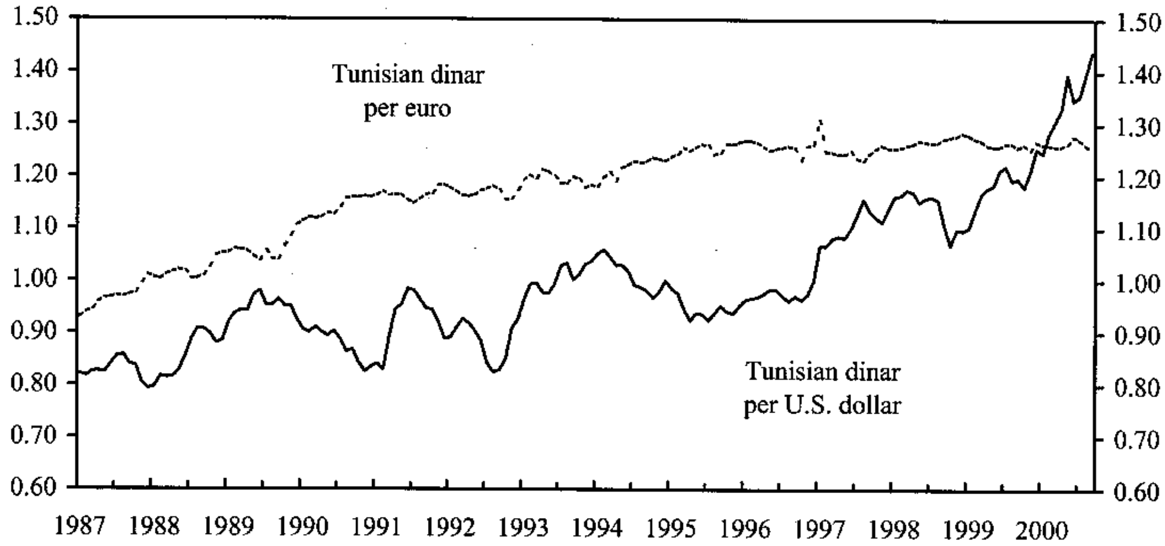


Sources: Data provided by the Tunisian authorities; and staff estimates.

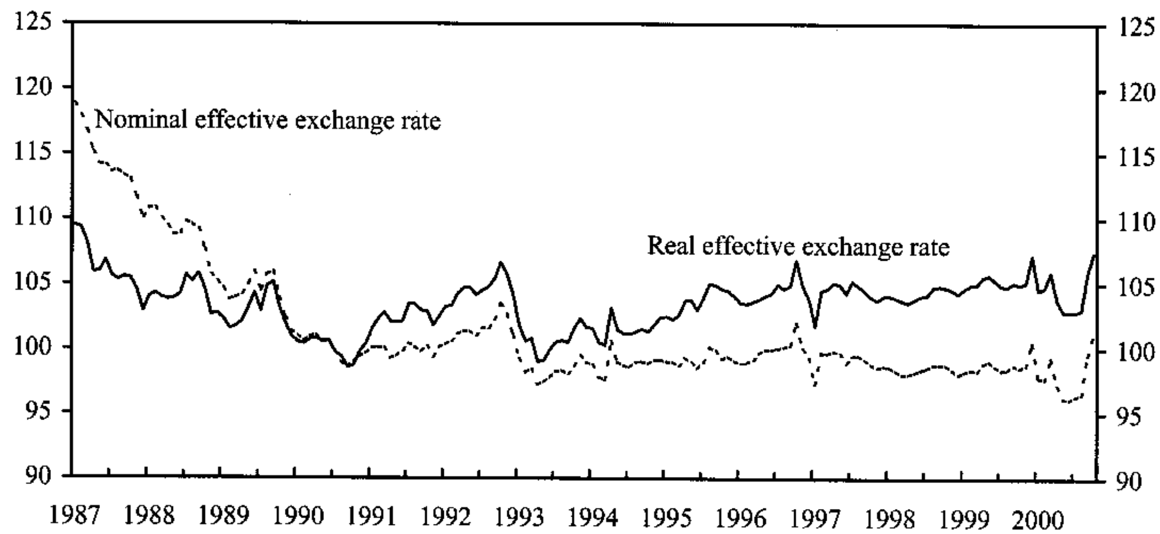
1/ Counterparts to M3, excluding other items net.

2/ Based on inflation over the preceding 12 months.

Chart 7. Tunisia: Exchange Rate Indicators, 1987-2000



(Indices, 1990=100)



Sources: International Monetary Fund, Information Notice System, and International Financial Statistics; and staff estimates.

III. POLICY DISCUSSIONS

13. **With no evident risks to macroeconomic stability in the short-run, discussions centered on the economy's medium-term prospects** and the prerequisites for moving to a higher growth path, consistent with the authorities' objectives of lowering unemployment and sustaining steady increases in real wages and living standards. These objectives will be fully articulated in the 10th Economic and Social Development Plan (covering 2002-06), to be formulated in a context of nationwide consultations in the course of 2001.

A. Medium-Term Outlook and Challenges

14. **Based on the strength of economic fundamentals and past policy performance, the mission took the view that annual GDP growth could rise to around 7 percent by 2006.** The macroeconomic conditions needed to reach this objective are spelled out in the staff's medium-term scenario of Table 8 and the underlying assumptions are described in Box 2. Based on continued strong growth in labor and TFP and sustained human capital accumulation, reaching the growth objective would require:

- **An increase in the fixed investment rate to 29 percent of GDP by 2006,** from 26 percent presently.
- **An average rate of growth of exports of goods and services of 6.3 percent per year (in volume terms),** corresponding to sustained gains in Tunisia's market share.[7]
- **A decline in the fiscal deficit to around 1 percent of GDP by 2006** in order to contain pressures on the external current account balance originating from the increase in investment.

15. **If attained, the growth objective would allow a reduction in the unemployment rate from 15.5 percent in 2000 to 11.0 percent in 2006,** thanks to an acceleration in employment growth (3.4 percent per year). The external debt ratio would be on a clear downward path, declining markedly in 2001 (to 44 percent of GDP from 49 percent in 2000) on account of large FDI inflows associated with privatization (as discussed in the next section).

16. **The key to meeting the above objectives lies in attracting private investment and generating sufficient productivity gains to strengthen competitiveness.** The decision to fully expose the domestic manufacturing sector to European competition by 2008 (under the AAEU) should provide a significant productivity impulse, provided resources are allowed to be redeployed to their most productive uses. To that end, staff pointed out the need to reinforce structural reforms on the following three fronts:

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[7] During 2001-06, the growth scenario requires a cumulative growth of non-oil goods exports of 50 percent, compared to a projected growth of Tunisia's export market of 43 percent (*World Economic Outlook* projections, Summer 2000).

Box 2. Tunisia: Medium-Term Scenario: Assumptions

The medium-term projections are based on a target path of real GDP growth over the period 2001-06. The supply and demand side requirements implied by this objective are derived from the following assumptions.

Supply side

On the supply side, the key tool of analysis is the aggregate production function of Mankiw, Romer and Weil (1992),[1/] where output (Y) is assumed to be a Cobb-Douglas function of physical capital (K), human capital (H), and labor (L), with factor shares of one-third for each of the factors.[2/] Denoting TFP by A, the production function reads:

$$Y = AK^{\alpha} H^{\beta} L^{1-\alpha-\beta}, with \ \ \alpha = \beta = 1/3.$$

Assumptions are made for TFP growth, labor productivity growth and human capital growth based on historical trends and on expected future economic policies. Specifically, TFP growth is assumed to rise to 1.3 percent per year, from an average of 0.4 percent in 1989-94 and 1.1 percent in 1994-99. Labor productivity growth is assumed to rise to 3.1 percent by 2006, from an average of 0.8 percent in 1984-89, 1.8 percent in 1989-94 and 2.6 percent in 1994-99. This assumption also reflects the authorities' objective of sustaining strong real wage increases. Finally, average human capital, measured by the average number of years of schooling in the population over 15 years old, is assumed to grow at 2.5 percent, slightly slower than 2.9 percent in the early 1990s. This slight decline in the growth rate of average human capital is in line with its downward historical trend and can be attributed to the gradual closing of the literacy gap. Under these assumptions, employment would grow on average by 3.4 percent per year[3/] and physical capital by 5.7 percent, resulting in an increase of the fixed investment rate to 29 percent of GDP by 2006.

Demand side

On the demand side, the key tool of analysis is the national accounts identity:

$$Y = C_P + C_G + I_F + I_S + X - M,$$

where C_P denotes private consumption, C_G public consumption, I_F gross fixed capital formation, I_S changes in stocks, X exports and M imports. I_F is determined from the supply side, and projections are made for the growth of C_P, C_G, I_S and M, allowing to derive the export growth from the GDP growth target. The projections of consumption, investment and import growth are based on the following assumptions:

- It is assumed that the reforms of the financial and insurance sectors will help mobilize private savings, and thereby, outweigh the effects of strong income growth and tariff reductions on private consumption. This assumption is reflected in a marginal propensity to consume slightly lower than its historical value.
- The fiscal adjustment is assumed to generate a reduction of the share of public consumption in GDP by 1 percentage point over the period 2001-06.
- Changes in stocks are assumed to decrease as a share of GDP, reflecting an expected improvement in the efficiency of the economy.
- Imports are projected by category of goods and non-factor services, based on category-specific price and income elasticities, in line with the historical evidence.

From real to nominal

Inflation is projected to decelerate from 3 percent in 2000 to 2.1 percent in 2006, in line with the authorities' objectives. Prices are assumed to follow the same path as the CPI, except for energy prices which reflect the World Economic Outlook assumptions.

1/ Mankiw, Gregory, Romer, and Weil, 1992, "A Contribution to the Empirics of Economic Growth," *The Quarterly Journal of Economics*, Vol. 107, 2 (May), pp. 407-37.

2/ Based on data for the average wage and the total workforce, the share of workers' remuneration in output is around 60 percent, close to the two-thirds implied by the model for the combined factor share of human capital and labor.

3/ Employment growth is derived by subtracting labor productivity growth from GDP growth.

- **Ensuring efficient financial intermediation,** so as to mobilize private saving more effectively and improve the allocation of capital.

- **Accelerating the liberalization of the economy and its opening to private sector initiatives** in order to exploit unused productivity potentials.

- **Pursuing labor market reforms** to support the creation of new activities and to enable enterprises to respond flexibly to changing opportunities.

17. **Labor market performance is unlikely to improve in the absence of significant increases in private investment and competitiveness.** An alternative scenario assuming an unchanged fixed investment rate (26 percent of GDP) and unchanged (total factor and labor) productivity growth results in GDP growth of 5.5 percent per year, generating insufficient job creation to reduce the unemployment rate.[8] Assuming the same expenditure path as in the higher growth scenario, the fiscal deficit would decline only marginally. Still, the lower investment requirement would result in a lower current account deficit (1.9 percent of GDP in 2006).

18. **The high growth scenario is also predicated on preserving existing macroeconomic equilibria by adapting macroeconomic policies to the changing needs and structures of the economy.** For fiscal policy, this means overcoming existing rigidities stemming from the high wage bill and extensive tax exemptions so as to continue down the path of deficit reduction, while reorienting expenditures to the needs of a modern economy. For monetary policy, the challenge is to modernize the monetary policy framework and develop money and debt markets in line with the progressive strengthening of the banking sector. As for exchange rate policy, the priority should be on broadening the set of competitiveness indicators used to guide policy. Eventually, as financial markets develop and capital flows are more fully liberalized, market forces could play a greater role in determining exchange rates.

B. Fiscal Policy

19. **The mission underscored the importance of persevering with fiscal consolidation** in order to raise national savings, contain potential pressures on the external accounts, maintain low real interest rates, and offset the projected decline in the social security surplus.

20. **The authorities confirmed their commitment to deficit reduction, as reflected in the draft budget law for 2001**, which targets an adjustment of 0.5 percent of GDP relative to the 2000 budget law, mainly through the containment of non-wage current expenditures and transfers. However, the wage bill is due to increase by some 8 percent, due to discretionary wage increases, wage drift, and net recruitment of 7000, each factor accounting for about one-third of the overall increase. No major revenue measures are being introduced to offset the expected loss in tariff revenues (0.2 percent of GDP) associated with trade

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[8] More employment growth could be generated through lower real wage increases, i.e., a lower labor productivity growth assumption. However, this would run counter to the authorities stated objective of maintaining real wage growth at the current rate.

liberalization. On the basis of conservative revenue assumptions—most of the surge in the tax to GDP ratio observed in 2000 is expected to be reversed—the budget deficit (excluding grants and privatization receipts) should decline to 3.2 percent of GDP. The overall fiscal deficit (including the social security surplus) is projected to decline only slightly, to 2.8 percent of GDP in 2001, reflecting the narrowing surplus of the social security funds (from 0.5 percent of GDP in 2000 to 0.4 percent in 2001).

21. **If the authorities succeed with their ambitious privatization plans, there may not be any need for debt financing in 2001.** Shortly after the mission's departure, the government announced that 41 public enterprises (with a book value of around US$1.3 billion equivalent to over 7 percent of GDP) would be privatized in 2001. While some of the privatization revenues will be earmarked for capital projects and special initiatives (e.g., the Employment Fund), the bulk is intended for debt reduction. If even half of the book value amount is realized, government debt would decline from 54 percent of GDP in 2000 to 48 percent in 2001.

22. **The mission recommended that budgetary consolidation proceed at a faster pace beyond 2001** in order to meet the objectives set out above and offset declining social security surpluses. In a context of falling trade tariff revenues, the mission stressed that deficit reduction could only be sustained by addressing existing fiscal rigidities (the wage bill and the narrow tax base). Indeed, the scope for compressing discretionary current expenditure (4 percent of GDP)[9] has narrowed, as the government will have to meet expenditure pressures linked to economic restructuring, human capital accumulation, and the modernization of public administrations.

23. **The wage bill constitutes the main budgetary rigidity.** At 11.6 percent of GDP in 2000, the wage bill is relatively high by international standards and shows no signs of declining.[10] The authorities indicated that new recruitment was limited to the higher education and health sectors and that, to the extent possible, demands from other sectors would be met through redeployment of staff. The mission warned, however, that redeployment alone might not be sufficient and that deeper reforms would be needed to lighten the burden of the wage bill on the budget over the medium term, while improving the efficiency of the civil service. In view of the long lead times required to formulate and implement such reforms, the mission urged the authorities to launch immediately evaluation studies of the civil service and the remuneration system that would help identify possible areas for reform.

24. **The mission underscored that considerable saving can also be realized on foodstuff subsidies** (0.7 percent of GDP), particularly in view of the social inefficiency of these expenditures which benefit mostly Tunisia's middle class. In this respect, the mission

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[9] Current expenditure, excluding wages, interest, and social security transfers.

[10] By comparison, in 1998, the government wage bill as a share of GDP was 6.5 percent in Egypt, 6.8 percent in Jordan, 11.5 percent in Morocco, 7.3 percent in Turkey, 7.9 percent in Greece, 8.4 percent in Argentina, 4.4 percent in Chile, 7.7 percent in Malaysia, and 6 percent in Thailand (IMF staff estimates).

regretted the authorities' decision to forgo, in 2000, the usual summer increase in the prices of subsidized food items. The authorities explained that this constituted only a pause in their ongoing strategy of gradually phasing out these subsidies, justified by the need to counteract the social impact of higher petroleum prices. They noted that an upward price adjustment in subsidized food prices was built into the 2001 budget, so as to produce a saving of TD 10 million (0.03 percent of GDP).

25. **On the revenue side, the mission stressed the need to widen the tax base**, as the main instrument for offsetting the expected decline in trade tariff revenues—tariff revenues are projected to decline from 2.8 percent of GDP in 2000 to around 1.5 percent in 2008. Steps taken in this direction in 1999, in particular the increase in the minimum corporate tax to 20 percent, already seemed to have resulted in greater buoyancy of tax revenues in 2000. While no major new measures were being envisaged for 2001, the authorities noted that the adoption of a new fiscal code (to become effective in 2002) would further improve tax collection in a context of greater transparency.[11] In the view of the mission, the rationalization of tax expenditures (worth 1.7 percent of GDP) constitutes another important avenue for reform, particularly given the doubts over the effectiveness of some tax exemptions, such as those on reinvested earnings. From an efficiency standpoint, the mission also urged greater neutrality in the tax treatment of the domestic (on-shore) and export (off-shore) sectors, stressing that the tax advantages given to the exporting sector had lost significance in a context where tariff reductions were placing domestic and exporting firms on the same competitive footing. While open to reform, the authorities countered that the effectiveness of tax incentives (in terms of attracting investment) could not be dismissed without a more careful analysis, and that impact studies were needed before considering a reform of the 1994 investment code.

26. **On current demographic trends, the social security accounts will be in deficit starting in 2006**; the fund for the public sector will be in deficit in 2002 and the surplus of the private sector fund will evaporate by 2010. A rising dependency rate is at the root of the structural imbalance in both funds, but in the public sector fund, the imbalance has been aggravated by the generosity of pensions—e.g., increases granted to current workers are automatically extended to pensioners. In addition, the public sector fund has had to bear the cost of early retirement packages offered as part of public enterprise restructuring, as well as the cost of consolidating into the fund stand-alone unfunded pension schemes of some public enterprises. The authorities agreed with the mission that, henceforth, the budget would have to cover the cost of early retirement packages. To address the imbalance of the social security accounts over the medium term, the authorities were contemplating an adjustment in

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[11] The new fiscal code (*code des procédures fiscales*) is a formal codification of existing and new laws, enshrining the statutory rights and obligations of the government and taxpayers. The new code places tax litigation under the general legal code *(droit commun)* and requires all dealings with the tax administration to be in written form. In addition, it reinforces the state's ability to collect taxes by: strengthening the ability of the tax administration to collect information, including by requiring banks to provide a list of all account holders, granting "executory" power to the tax administration, making all infractions under the code a criminal offense, and adding new criminal sanctions on value-added tax-related infractions.

contribution rates, but also envisaged deeper reforms based on the results of actuarial studies now under way. Recent reforms in the medical insurance scheme would also be adding to outlays, by shifting the cost of health services from public hospitals to users, i.e., the social security system, and through the extension of basic medical coverage. The authorities noted that they would have to offset this increase in social security outlays through a combination of higher contribution rates and cost containment measures.

C. Monetary, Exchange Rate and External Reserve Policies

27. **The authorities said monetary policy would continue to be guided by broad quantitative objectives**, set in terms of credit and monetary growth rates. The authorities did not anticipate the portfolio shifts into time deposits observed in 1999-2000 to continue in 2001, and were thus working on the assumption of an unchanged velocity of broad money and a projected growth in credit to the economy of 8.5 percent, or 1 percentage point below nominal GDP growth. The mission endorsed the authorities' framework but stressed that the major challenge for the coming year would be to manage the large liquidity injection coming from the FDI inflows associated with a possible new wave of large privatizations. As these budgetary resources are drawn down, the ministry of finance and the central bank would have to coordinate closely to avoid excessive monetary creation.

28. **The mission urged the authorities to disseminate more widely the monetary program in order to reinforce the anchoring role of monetary policy.** It stressed the importance of institutionalizing the credibility built up by the monetary authorities through a more transparent monetary framework. It welcomed, in this respect, the posting of the monetary framework on the central bank's website, and the authorities' decision to publish the 2001 monetary framework as part of the budget document. The mission suggested that these initiatives could be strengthened by an explanation of the monetary policy framework and its relation to the government's broader growth and inflation objectives.

29. **The mission recommended that the authorities rely to a greater extent on interest rate signals in the conduct of monetary policy.** It noted that moral suasion continues to play an important role in containing banks' credit growth and thus in achieving macroeconomic objectives. The development and diversification of Tunisia's economy and the strengthening of its banks and financial markets should gradually permit interest rates to play a more active role in credit allocation and rationing. The authorities were of the view that the banking sector was not yet mature and strong enough to respond appropriately to interest rate signals. They indicated, however, that a reform of the central bank's refinancing windows, which was under consideration, would allow greater flexibility in the interbank interest rate and promote the development of the money market.[12]

30. **The mission endorsed the authorities' emphasis on using the exchange rate instrument to maintain external competitiveness**, in as much as capital controls were likely to remain in place—and therefore, the exchange rate would continue to be largely

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[12] The instruments of monetary policy are described in Box 6 of the 1999 Article IV Staff Report (SM/99/201, 8/9/99). In line with IMF recommendations, the statutes of the central bank have been modified to allow it to hold government paper of all maturities.

insulated from market pressures. The mission pointed out that the equilibrium real exchange rate would be more difficult to predict in a situation where trade liberalization and productivity gains might proceed at different paces. In this context, the CPI-based real exchange rate—the main competitiveness indicator followed by the authorities in recent years—was likely to become a less reliable measure of competitiveness.[13] The mission urged the authorities to develop and rely on a broader set of indicators to guide exchange rate policy in the future, including export performance and unit labor cost developments. The authorities indicated that already they had begun following developments in relative market shares, and that the departure from the real exchange rate targeting rule observed in 2000 reflected the perceived limitations of the CPI-based real exchange rate.

31. **The authorities confirmed their intention to tap financial markets as necessary to reach their foreign reserve objective of US$2.2 billion by year's end.** They were comforted that this level, corresponding to three months of imports (and about 4.5 months if one excludes imports of intermediate goods by offshore enterprises financed from export proceeds), provided a sufficient cushion against unforeseen events. The mission encouraged the authorities to take a broader approach to reserve adequacy, and to monitor closely the reserve coverage of short-term financial liabilities. Under the current reserve target for end-2000, 90 percent of short-term liabilities (including debt coming due within one year) would be covered. In view of the limited scope for portfolio outflows and the generally stable nature of the deposits of non-residents, the mission deemed that this ratio provided a sufficient safety margin.

32. **Based on the current external reserve position and the relatively favorable balance of payments prospects for 2001, the authorities indicated to the staff their intention to advance to May 2001 the repurchase of the full amount outstanding under the 1992 Extended Fund Facility (EFF).**

D. Structural Reforms

Ensuring efficient financial intermediation

33. **Banking sector performance has strengthened under the impetus of public bank restructuring and tighter prudential controls and supervision.**[14] All major indicators of bank soundness have improved: the capital asset ratio for the commercial banking sector as a

[13] Trade liberalization is likely to induce changes in relative prices and in competitiveness that will not be reflected in relative CPIs. Thus, for instance, to the extent that downward pressures on domestic inflation stemming from trade tariff reductions on consumer goods are passed onto the exchange rate, export goods (whose prices are unaffected) lose competitiveness. Another limitation of the CPI-based rate is related to the existence of administered prices which may distort the measurement of inflation and thus of the real effective exchange rate (although in recent years, controlled prices have risen at a faster rate than market-determined prices).

[14] The ongoing reform of the banking sector is described in greater detail in Box 2 of the 1999 Article IV Staff Report (SM/99/201, 8/9/99).

whole rose to 10.1 percent in 1999, with only one small bank still failing to reach the minimum 8 percent ratio; and the level of unprovisioned bad loans was brought down to 14.1 percent of net liabilities from 18.4 percent in 1997. The authorities indicated that the clean-up operation of public enterprise debt and the public bank restructuring program supported by World Bank lending would be completed by year's end. Still, overall asset quality remains poor, with non-performing loans amounting to 20 percent of GDP in 1999 (all of it to the private sector). The authorities expected this ratio to decline over time as a result of tighter supervision and the measures taken to facilitate provisioning, write-offs and the establishment of loan recovery agencies (*sociétés de recouvrement*).

34. **Despite these improvements, the mission took the view that the credit culture would have to be strengthened further if the risks of accumulating new bad loans were to be contained.** While strong growth prospects should reduce credit risk, the restructuring and resource reallocation associated with trade liberalization could generate new pressures on banks' loan portfolios. In this context, the mission stressed the importance of improving corporate governance and transparency, particularly on matters of accounting, financial reporting and ownership structures. While poor lending practices were widespread across the banking sector, the ratio of non-performing loans to total assets is much higher for public banks (33 percent compared to 19 percent for private banks at the end of 1999).[15] Given the large role still played by public banks (60 percent of total banking sector assets) and the need to upgrade banks' risk management practices to the requirements of a more open economy, the mission urged the authorities to open public banks to foreign investment (through privatizations and equity participations). The authorities said that they would complete the privatization of two smaller public banks but that they intended to retain control over the three largest public banks because of their role in financing sensitive sectors: *Banque Nationale Agricole* (agriculture), *Banque de l'Habitat* (housing), and *Société Tunisienne de Banque* (small and medium-sized enterprises (SMEs)). The mission was reassured by the proposed reforms of the agricultural financing system, aimed at replacing direct budgetary support for the quasi fiscal activities undertaken by the state's agricultural bank (*Banque Nationale Agricole*). In combination with stronger banking supervision, these reforms should help avoid a systematic accumulation of arrears in the agricultural sector by excluding marginal producers from accessing bank credit.

35. **The mission noted that capital markets could play a more important role in mobilizing and allocating domestic and foreign saving.** The tax advantages introduced in 1999 in favor of equity financing do not appear to have had the desired impact on the stock market which, together with the bond market, continues to play a marginal role in enterprise financing compared to bank credit. On the issuing side of the market, the more demanding reporting requirements associated with capital market financing (compared to bank financing), and the fact that many large enterprises are still government owned, were generally viewed as the primary deterrents to new issues. On the investors' side, the authorities noted that the planned reform and restructuring of the financially troubled insurance sector would help revive the interest of institutional investors in capital markets. The domestic bond market was also being held back by the slow development of the secondary market in treasury paper. The authorities noted that many of the recommendations

[15] Public banks including development banks, some of which are part owned by the state.

made by Fund technical assistance in this area had been taken on board, and they expected that the introduction of a legal framework for repurchase operations (set for 2001) would help boost the market. The mission suggested that liberalizing foreign participation in the equity market beyond the current 50 percent ceiling would increase the attractiveness of the Tunis Stock Market.[16]

Accelerating economic liberalization and promoting private sector development

36. **Considerable efficiency gains could be realized in large segments of the economy by fully opening the economy to private sector participation and by removing remaining price controls and distortions.**[17] In the view of the mission, a concerted and major effort at privatization, liberalization, and administrative simplification was needed to realize these gains and thereby boost private investment and growth.

37. **The mission noted that privatization and liberalization had proceeded at too slow a pace, relative to the existing potential.** The privatization of three large cement factories in 1999-2000 (and the transfer of the industry to the private sector) constituted the most significant operation since the beginning of the privatization program in 1987. However, the state remains heavily involved in productive activities through some 120 public enterprises operating in most sectors of the economy, and accounting for about one-fifth of total value added. Inadequate information on the economic and financial performance of public enterprises does not permit an accurate assessment of their efficiency. Although the authorities indicated that the restructuring efforts undertaken over the 1990s had generally placed public enterprises on a sounder footing, non-commercial considerations were still likely to weigh heavily on their performance.[18] In this context, the mission stressed the importance of liberalizing and opening the economy further to private initiative, particularly in the service sector (telecommunications, transportation, and banks), not only because of the direct potential for growth in this sector, but also because of the broader impact on the economy's overall competitiveness.

38. **The authorities indicated that a major privatization and liberalization drive would be undertaken over the following 12 months.** In addition to the privatization of

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[16] The ceiling applies on an enterprise by enterprise basis.

[17] In particular, the following prices are still controlled by the state: petroleum, water, basic commodities (sugar, coffee, tea, cereals), electricity, telephone and some public services, including transportation. Intermediation margins on other food products (e.g., vegetables and fruits) are also regulated. In all, some 19 percent of prices at the retail level are still administered.

[18] On the basis of 1996 data collected by the World Bank, the profitability of public enterprises (gross operating revenues to total assets) was 8 percent compared to 12 percent for the private sector. The gap with the private sector was largest in agro-business, textiles, energy, commerce, transport, tourism and restaurants, and services.

41 public enterprises,[19] port activities would be open to the private sector; and the telecommunications sector would be liberalized, starting with the granting of a second mobile phone (Global System for Mobile Communication (GSM)) license to a private operator.

39. **Efficiency gains can also be had through broader trade liberalization.** As tariff dismantling on imports from the EU enters its last and accelerated phase, tariff differentials with the most-favored-nation (MFN) regime could create unwanted distortions and misallocations (see Box 3). The mission therefore welcomed the reduction introduced in 2000 in the tariff rate on selected goods that already benefit from free trade with the EU, although this only reduced the average tariff rate from 37.4 percent to 35.9 percent. The authorities pointed out that bilateral free trade agreements were aligning tariff rates with those prevailing on EU imports (agreement with Morocco) or accelerating the provisions of the Greater Arab Free Trade Agreement (agreements with Egypt and Jordan). Non-tariff barriers (NTBs) also came down in 2000, as Tunisia fully liberalized vehicle imports as agreed with the World Trade Organization (WTO). The authorities indicated that by year's end, import procedures would be simplified considerably with the establishment of a single filing system (accessible through the internet), and that in October 2001, Tunisia would be adopting WTO rules on import valuation. In this context, a new customs code was being prepared, which inter alia, would clarify arbitration procedures and rules of origin.

40. **Significant enterprise restructuring is still needed to adjust to trade liberalization**, particularly in the protected manufacturing sector which will be fully exposed to foreign competition by 2008 and in the textile sector that will face stronger competition in export markets with the phasing out of textile quotas under the WTO. The mission was encouraged by the considerable successes already registered under the government's program of enterprise modernization (*mise à niveau*).[20] Some 1,500 enterprises have applied to the program, out of the 2,000 originally targeted, and some TD 1.5 billion in investment in nearly 800 enterprises has already been approved. Preliminary results were very encouraging, with participating enterprises experiencing marked increases in turnover (15 percent per annum over 1996-99, and 13 percent on export markets) and in employment (6.6 percent per year). The mission pointed out the potential selection bias in these results, and indeed the authorities recognized that the program still has to make inroads in some of the least competitive sectors, particularly among SMEs. Lack of managerial competences was viewed as a main shortcoming for SMEs, and to overcome this hindrance the authorities had increased the subsidy element for non-physical investments—e.g., for the hiring of professional staff—under the *mise à niveau* program. The authorities also stressed that the textile sector was in a relatively strong position to fend off growing competition from cheaper Asian exports by moving up-market (to more vertically integrated and higher value-added production).

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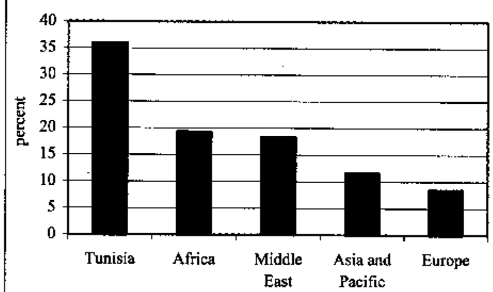
[19] The sectoral distribution of the enterprises on the privatization list is as follows: industry (19), services (19), financial sector (2), housing and construction (6), tourism (9), commerce (2), health (1), and agriculture (2).

[20] More details on the program can be found in Box 3 of the 1999 Article IV Staff Report (SM/99/201, 8/9/99).

Box 3. Tunisia: Developments in Trade Policy

Trade liberalization is an important element of Tunisia's development policy since its current regime is still very restrictive. Tunisia's trade regime is ranked an "8 out of 10" on the Fund's index of trade restrictiveness; the average MFN tariff rate is 35.9 percent (unweighted), the maximum rate is 220 percent and the tariff schedule has 50 different tariff rates. Over the past year, progress was made toward liberalizing the trade regime. NTBs also came down as Tunisia phased out barriers maintained for balance of payments reasons in mid-2000. Average tariffs declined from 37.4 percent to 35.9 percent and some 376 tariff lines (3 percent of total) were removed from the schedule. Even so, Tunisia's MFN tariffs are well above those for most other countries in the region and elsewhere (see Chart).

Simple Average MFN Tariff Rates, 2000



Source: IMF staff estimates.

Despite relatively high MFN tariffs, exports remain competitive. Export processing arrangements play an important role in the competitiveness of Tunisia's exports while restrictions on competing imports into the EU also help. Tunisia's manufactured exports benefit from offshore status and duty drawback facilities which allow goods to be imported duty free provided they are used for export processing. Tunisia's industrial exports receive duty and quota-free access to the EU market, Tunisia's main export market. At the same time, the EU will maintain quotas and import duties on imports of textile and clothing products from many competing sources until end-2004. Under WTO rules, textile and clothing exports from all sources will receive quota-free access to the EU as of 2005, thus increasing competition in Tunisia's main export market.

Tunisia is liberalizing its trade regime through bilateral agreements with the EU and other countries in the region. The AAEU, concluded in 1995, is to be phased-in over a 12-year period. Already tariff rates on manufactured good imports from the EU are substantially lower than under the MFN regime (see Table). Tunisia also maintains preferential trade arrangements with Algeria and Libya. It has entered into bilateral free-trade agreements with Egypt, Jordan and Morocco, and is a signatory to the Greater Arab Free Trade Agreement. In all, these agreements should foster greater regional integration and effectively open the domestic manufacturing sector to competition.

Tunisia: Average Tariff Rates, 2000-01

	MFN	EU Preferential Tariffs	
	2000	2000	2001
All products	35.9	28.5	25.6
Agriculture	77.1	77.1	76.7
Manufacturing	25.0	16.0	12.5

Source: IMF staff estimates.

While bilateral agreements contribute to trade liberalization, the following concerns remain:

- Imports from third countries remain subject to very high tariffs and the gap is widening.
- Agriculture is currently excluded, although negotiations with the EU are expected to lead to some opening in 2001.
- Under the AAEU, tariffs on raw materials and intermediate inputs have declined since 1996, but tariffs on competing imports only start declining as of 2001. Thus, so far the decline in tariffs has contributed to an increase in effective protection for Tunisia's manufactured sector and the protection-reducing benefits of the agreement are backloaded.
- Preferential agreements are difficult to administer as tariff preferences are granted only to imports which satisfy the rules of origin, thus increasing opportunities for rent-seeking behavior.

41. **Over the medium term, closer financial integration into the world economy could be a source of additional efficiency gains.** However, the authorities remained very skeptical of liberalizing portfolio flows, citing their potentially destabilizing effects. They noted that the exchange regime provided all the necessary freedom for enterprises to operate competitively in domestic and export markets.[21] In view of the prior need to strengthen the banking sector, develop domestic capital markets, and make progress on price and trade liberalization, the mission noted that it was indeed premature to envision a broad-scale liberalization of financial transactions.

Modernizing the labor market

42. **The youth unemployment rate has been consistently higher than the average rate**, and the gap has been widening since 1994, suggesting that the unemployment problem is essentially related to the insertion of new entrants into the labor force and that the average search time for a first job has been increasing (Chart 8).[22] The fact that youth unemployment (as well as the unemployment gap relative to older workers) is more severe at higher education levels possibly reflects the need for longer job searching as educational attainment rises, or alternatively a greater skill mismatch.

43. **By contrast, unemployment due to job loss still accounts for a relatively small share of total unemployment,** despite the ongoing restructuring of public and private enterprises. The authorities credited their gradualist and careful approach to privatization and liberalization for preserving jobs. They noted in particular that privatizations would continue to be linked to employment guarantees (during a transition period) as this was an important element in securing the union's support for the privatization process. According to the staff, however, the degree of economic restructuring implied by trade liberalization and strengthened domestic competition would inevitably lead to some labor shedding by inefficient firms.

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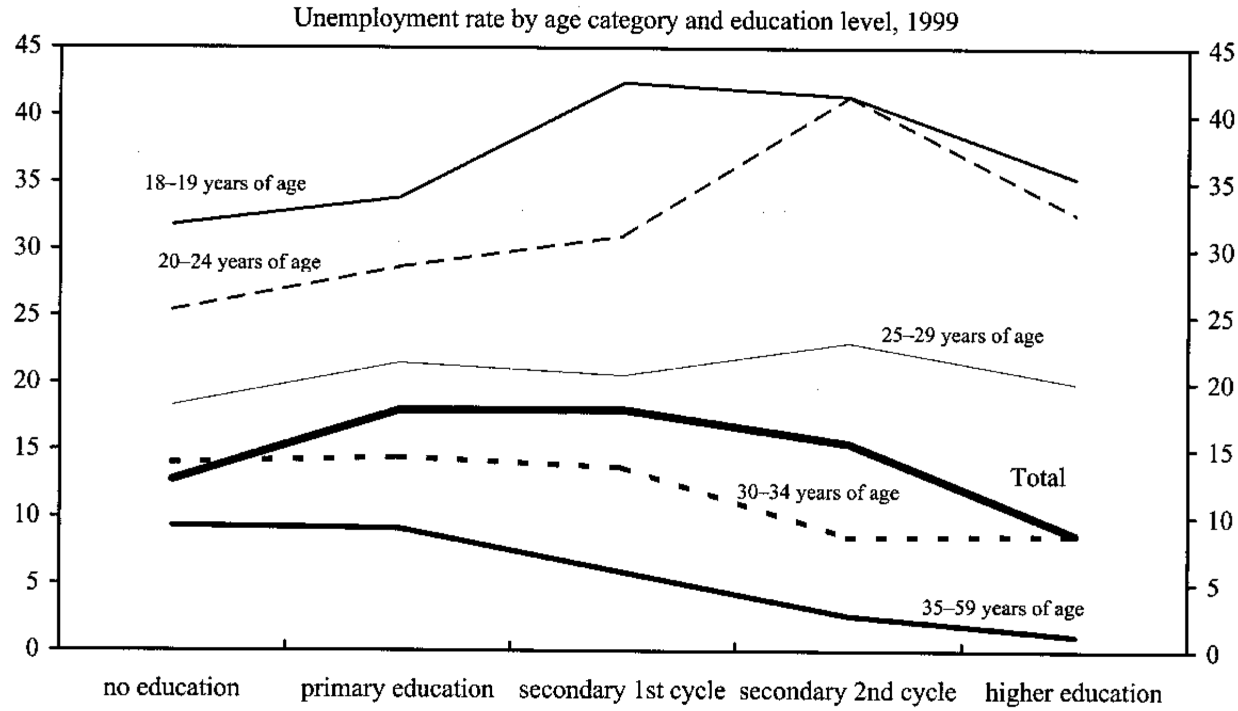
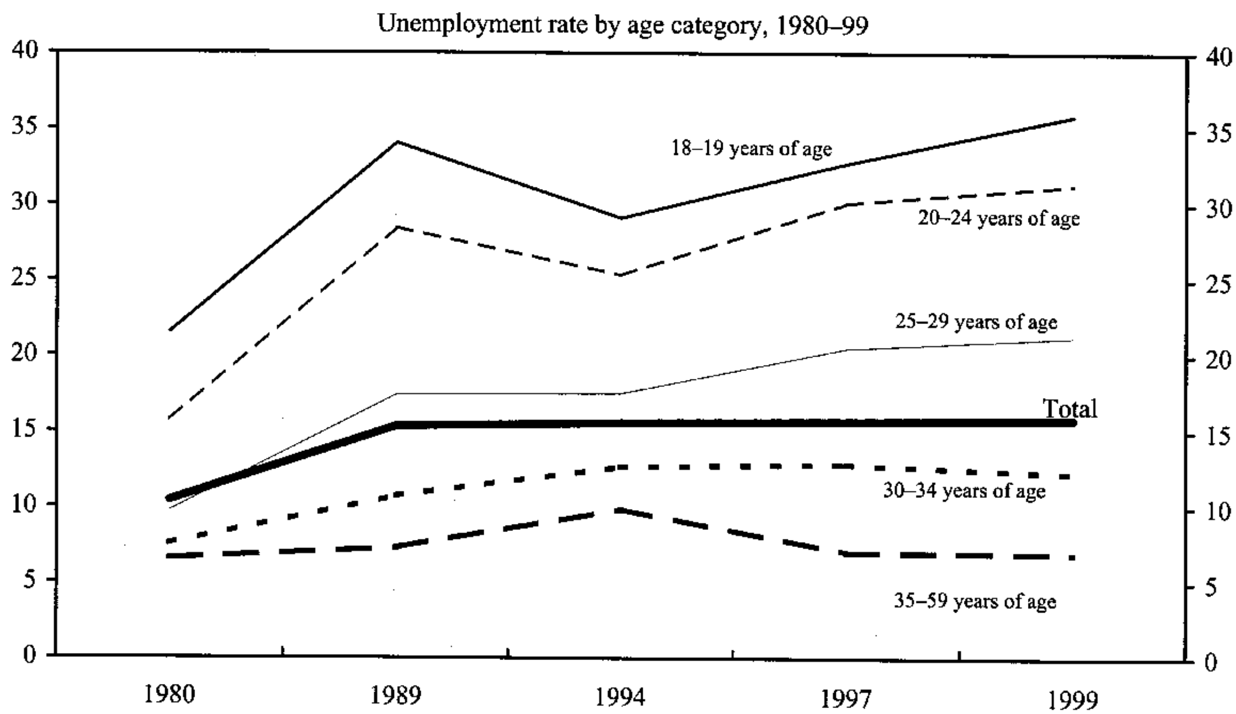
[21] Non-resident FDI and equity purchases are free of restrictions, although participations in excess of 50 percent are subject to authorization by the High Investment Committee. The acquisition of debt instruments by non-residents is subject to authorization. Offshore (non-resident) companies can borrow in dinars to cover their local expenses. Resident enterprises can borrow abroad for commercial and investment purposes up to TD 3 million (TD 10 million for financial institutions) and can engage in outward FDI for up to TD 9 million, without authorization. All portfolio and real-estate transactions by residents are otherwise subject to authorization. The ceiling on foreign exchange deposits of resident enterprises has been raised to 50 percent of foreign exchange receipts (it can go to 100 percent with authorization), and enterprises can cover their commercial foreign exchange exposure (but not financial exposure) in the forward exchange market.

[22] The authorities' measure of the unemployment rate differs from the International Labor Organization definition in two respects: (i) it uses a broader definition of active labor force that includes unemployed individuals who are not actively searching for a job; and (ii) it is based on a definition of labor force that only includes the population between the ages of 18 and 59. The two factors tend to offset each other, and the net effect is unlikely to be large.

Chart 8. Tunisia: Unemployment Rates, 1980–99
(In percent)





Sources: *Enquête population-emploi*, 1980, 1989, 1997, 1999; *Recensement général de la population et de l'habitat*, 1994; *Institut National de la Statistique*, Tunis.

44. **An impressive array of active labor market policies have been put in place to improve labor market performance.** In addition to the existing micro-credit schemes and training programs,[23] the 2000 budget introduced a national employment fund (*Fonds national de l'emploi*) financed by budgetary (including privatization proceeds) and voluntary contributions and targeted at the hard-core unemployed. The fund will dispose of some TD 70 million a year (TD 45 million in 2000) to finance self-employment projects and the creation of small enterprises, retraining of college graduates that will increase their "employability," vocational training for unskilled job-seekers, and community service work. The authorities have also reinforced their job-placement services through the development of an internet site designed to facilitate job search and match employers with job seekers and they intend to promote further the development of the high-tech sector as a potentially important source of jobs for recent graduates. To improve job market monitoring, the authorities plan to increase the frequency of labor market surveys to an annual basis, starting in 2000. The mission welcomed the emphasis placed on skill improvement and entrepreneurship and the experimental nature of the various schemes. This will require, however, that the effectiveness of these programs be carefully monitored, particularly as job losses linked to economic restructuring may change the nature of unemployment.

45. **The mission questioned whether the present labor code, and in particular its restrictive firing provisions, would not hinder employment growth and reallocation** in a context of a more open and dynamic economy that requires greater labor market flexibility.[24] It suggested that the social concerns that underlie the job security provisions of the labor code could be addressed through other means, including a partial unemployment insurance scheme. The authorities did not perceive the labor code as a hindrance in the present context, and noted that it was generally not an issue with employers. They were also strongly opposed to establishing any form of unemployment insurance, lest it undermine work incentives.

46. **The mission suggested that greater wage dispersion across enterprises would be desirable to facilitate the redeployment of resources toward more productive enterprises.** This could be achieved within the present wage setting framework by agreeing to minimum (sectoral) wage increases and possibly indicative average increases. The authorities indicated that reforms could be envisaged for the next wage round in 2002.

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[23] Over the first 11 months of 2000, some US$33 million in micro-credits (averaging US$2,500) were disbursed by the Tunisian Solidarity Bank, leading to the creation or protection of some 17,000 jobs.

[24] Firings are subject to official authorization and a survey of foreign investors commissioned by the U.S. Agency for International Development cited difficulties in employee reductions as an impediment to efficient operations and a deterrent to investment (*Etude des attentes des entreprises nord-américaines en Tunisie quant aux formalités d'investissement, mars 2000*, Price Waterhouse Coopers).

IV. Statistics and Other Issues

47. **Considerable progress has been made to improve the quality and the dissemination of statistical information**, and Tunisia is aiming to subscribe to the SDDS by mid-2001—the slight delay relative to the original end-2000 target date is needed primarily to finalize work on quarterly national accounts data (see Appendix III). Data required for the SDDS reserves template on international reserves, foreign currency liquidity and forward exchange rates are currently available, although their dissemination is scheduled to begin only in February 2001. Tunisia generally provides satisfactory economic and financial statistics for surveillance. Subscription to the SDDS will result in significant improvements in the frequency and the statistical coverage of Tunisia's national accounts, labor market and fiscal data. Nevertheless, further information is required in the area of public enterprise reporting in order to allow for full and effective surveillance. While there appears to be no major financial imbalance in the public enterprise sector taken as a whole and the quasi-fiscal activities of public enterprises are reportedly fully financed through budgetary transfers, more information on the operational and financial position of individual enterprises is needed to assess their viability and to identify possible contingent liabilities for the budget.

48. **The authorities provide information on environmental programs and military spending.** With respect to the environment, all programs covered in the budget are executed by a state agency. In 2000, expenditure on the environment is estimated at 76 million dinars (0.3 percent of GDP), including current spending, capital investment, and subsidies to the private sector. Security-related spending is estimated at 4 percent of GDP in 2000 (1.6 percent of GDP for "defense," and 2.4 percent of GDP for "order and public security").

49. **The phasing out of Tunisia's outstanding multiple currency practices (MCP) was delayed from 2000 to 2001** owing to litigation over the exchange rate guarantees that were at the origin of the MCP (see Appendix I).[25]

V. Staff Appraisal

50. Over the years, the Tunisian economic and social development model has produced laudable results in terms of growth, income distribution and social advances. It is based on a combination of cautious and flexible macroeconomic policies, gradual economic liberalization, and progressive social policies. Considerable rigidities remain, however, in the economy. Unless they are addressed, the ensuing efficiency losses are likely to become more binding (on growth and employment) and to dampen the potential gains from Tunisia's outward-oriented growth strategy.

51. On the basis of Tunisia's track record of sound macroeconomic policies and the economy's strong fundamentals, staff believes that the authorities can reasonably aim for higher growth, and thus a sustained reduction in the rate of unemployment over the medium

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[25] Litigation originated from the loss (in a flooded basement) of the official records of the operations to which the exchange rate guarantees applied. The agreed settlement provides for the deferred payment of the guarantees in 2000 and 2001.

term. Achieving this objective is closely linked to completing the process of liberalization and transition to a fully open and market-driven economy. Ongoing trade liberalization with the EU is a central element of this strategy and should act as an important source of productivity gains and growth potential for the economy, provided it is accompanied by an accelerated pace of MFN trade liberalization and structural reforms to ensure the efficient allocation of resources and to support the development of the private sector.

52. Attainment of the authorities' medium-term growth objective also relies on preserving macroeconomic stability in a more open environment. Containment of the fiscal deficit and of credit growth, combined with active incomes policy and an exchange rate policy geared to maintaining external competitiveness have contributed to reducing the government debt ratio, preserving price stability and containing external imbalances. Tunisia's pragmatic approach to exchange rate policy in the face of a weakening euro in 2000 also illustrates the authorities' ability to react rapidly and flexibly to economic policy challenges.

53. Looking forward, the main challenges for fiscal policy over the medium term are to put the fiscal deficit on a clear downward path while improving the structure of the budget. Although the present fiscal stance is sustainable (in terms of the projected evolution of the debt ratio), a stronger fiscal position will be needed to offset expected pressures on the external accounts stemming from higher growth and investment.

54. Thus, while recognizing the efforts undertaken to contain the deficit in 2001, staff recommends that the authorities set more ambitious deficit targets in the future, especially in view of the favorable growth prospects. Budgetary adjustment will also have to offset the structural deterioration in the social security accounts. In order to realize these objectives without cutting back on productive social and investment spending, the authorities will need to address the main sources of budgetary rigidity, namely the wage bill and the extensive system of tax exemptions. Given the considerable amount of preparatory work required for civil service and tax reform, staff urges the authorities to initiate work in these two areas as soon as possible. Staff remains available to assist the authorities in assessing the current tax incentive structure and in formulating appropriate reforms to rationalize the tax system and achieve greater neutrality. Staff also notes the authorities' commitment to continue with the gradual phasing out of generalized food subsidies, despite the pause of 2000. In view of the relatively low incidence of poverty in Tunisia, this redistribution instrument is particularly inefficient, and staff believes that subsidies could be eliminated at a considerably faster pace than envisaged.

55. Rising dependency ratios are producing the same structural deterioration in Tunisia's social security accounts as found in other countries facing similar demographic trends. In Tunisia, the problems have been compounded by unduly generous pension schemes and by drawing on past social security surpluses to finance early retirement schemes and other quasi-fiscal activities. The measures already taken since 1994 and the reforms under preparation reassure the staff that the authorities are in a position to deal with the issue in a timely manner.

56. Through prudent monetary policy management, based on the containment of credit growth, the central bank has built up considerable credibility over the years. Staff believes that, as Tunisia evolves toward a more open and market-driven economy, greater transparency with regard to the monetary policy framework and instruments would help strengthen the anchoring role of monetary policy. In this respect, staff welcomes the monetary authorities' decision to post the monetary program objectives on the central bank's website and to integrate them in the next budget document. It encourages the authorities to use these publication vehicles to provide more detailed monetary policy assessments.

57. Weaknesses in the banking sector and underdeveloped debt markets have until now limited the scope for relying on interest rate signals to allocate financial resources efficiently. In view of the improved financial situation of banks and the development of the treasury bill market, staff considers that monetary policy could begin to rely more on interest rate signals and on market-based instruments of control. As a first step, it encourages the authorities to proceed with a reform of the central bank refinancing windows so as to inject greater flexibility in the interbank interest rate.

58. With capital mobility unlikely to increase substantially in the near future, the authorities will continue to be able to pursue separate monetary and exchange rate objectives. Staff believes that the CPI-based real exchange rate that has guided exchange rate policy until recently will become a much less reliable gauge of competitiveness in a context of trade liberalization, and that consequently exchange rate policy should be guided by a broader set of indicators. Staff, therefore, welcomes the central bank's decision to monitor developments in relative export market shares, which led to its decision in 2000 to depart from the fixed real exchange rate rule in the face of a weakening euro.

59. The marked improvement in the terms at which Tunisia has tapped international financial markets further attests to the strength of her fundamentals. The staff commends the authorities for using this opportunity to restore a more comfortable level of reserves relative to the levels observed earlier in the year, and encourages them henceforth to maintain an adequate reserve coverage, not only in terms of imports but also in terms of short-term liabilities.

60. The key to moving the economy to a higher growth path lies in the structural reform agenda, and in particular in mobilizing the private sector to develop the significant unexploited areas of productivity and growth potential, in both the protected manufacturing and services sectors. To realize these potential gains, staff considers that the time has come to step up considerably the pace of deregulation and liberalization beyond the very gradual approach followed until now. The investments made to modernize the private sector and develop private entrepreneurship through the *mise à niveau* program should indeed have prepared the private sector for the challenge. An important step toward economic liberalization would be achieved with the completion of the announced privatization of 41 state enterprises over the coming 12 months, and opening of the service sector to private sector activity, notably in telecommunications and port activities. These measures need to be accompanied by price liberalization and even broader deregulation of the economy.

61. Staff congratulates the authorities for the progress made in the last couple of years to put the banking sector on a sounder footing, as witnessed in the improvement in prudential ratios. Still, the large portfolio of non-performing loans will continue to weigh heavily on the economy, and staff believes that greater corporate transparency and improved risk analysis in the banking sector are needed to limit the risks of accumulating new bad loans. To reinforce risk management, staff also suggests that the authorities consider opening, in the near future, the capital of the three main public banks to foreign capital, through privatization or minority participations.

62. As tariff reductions under the AAEU enter into their last and accelerated phase, the gap between the AAEU and the MFN regime has been widening, leading to potentially serious distortions. The authorities have taken steps to narrow this gap in 2000 and have reduced NTBs (notably quotas on vehicles) as agreed with the WTO. However, the average MFN tariff rate declined only marginally (by 1.5 percentage points to 36 percent). In view of the highly restrictive nature of the MFN trade regime, staff urges the authorities to reduce MFN tariff rates at a much faster pace.

63. Although, in time, closer integration into world capital markets can result in additional efficiency gains, staff considers that significant further liberalization of the financial account is not appropriate until additional progress is made to strengthen the banking sector and domestic capital markets. Nonetheless, staff considers that greater openness to portfolio inflows, for instance by removing the 50 percent approval ceiling on foreign holdings of domestic enterprises, would be beneficial to the development of capital markets and enterprises.

64. The authorities have rightly focused on reducing unemployment as their ultimate policy objective. Supporting the overall growth strategy, an impressive number of measures have been deployed to improve job placement, training, and self employment. Labor market institutions, and the centralized wage setting mechanism in particular, have contributed to price and social stability, although at the cost of very limited wage flexibility and dispersion across enterprises. To facilitate restructuring, staff encourages the authorities to find ways for wages to better reflect relative productivity performances. Similarly, staff suggests that the authorities be mindful of the potential costs of the restrictive provisions of the present labor code as the need for labor market flexibility is likely to increase with the opening of the economy.

65. Staff commends the authorities on their decision to advance to May 2001 the repurchase of the full amount outstanding under the 1992 EFF arrangement.

66. Effective January 6, 1993, Tunisia accepted the obligations of Article VIII and its exchange system is currently free of restrictions on the making of payments and transfers for current international transactions, except for certain restrictions imposed pursuant to the UN Security Council resolutions (see Appendix I), and the maintenance of a multiple currency practice resulting from honoring exchange rate guarantees extended prior to August 1988. The government is not seeking, and the staff is not recommending approval of this MCP, which will expire in 2001.

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

Table 1. Tunisia: Basic Economic and Financial Indicators, 1995–2001

	1995	1996	1997	1998	1999	Projected 2000	2001
	(Annual percent change; unless otherwise indicated)						
Production and income							
Nominal GDP	7.9	11.8	9.6	8.1	9.9	8.4	9.5
Real GDP	2.4	7.0	5.4	5.0	6.2	5.0	6.2
GDP deflator	5.5	4.5	4.0	3.5	3.5	3.2	3.1
Consumer price index (CPI), average	6.3	3.8	3.7	3.1	2.7	3.0	2.9
Gross national savings (in percent of GDP)	20.2	22.4	23.2	23.5	24.5	24.5	24.8
Gross investment (in percent of GDP)	24.7	25.1	26.5	26.9	26.6	27.7	27.8
External sector (percent change)							
Exports of goods, f.o.b. (in US$)	17.8	0.9	0.7	3.1	2.3	2.2	6.8
Imports of goods, f.o.b. (in US$)	20.1	-2.4	3.2	5.0	1.5	3.4	6.6
Exports of goods, f.o.b. (volume)	3.0	-2.4	10.1	6.3	6.7	6.4	6.6
Import of goods, f.o.b. (volume)	6.2	-2.4	8.5	5.5	5.9	7.3	6.4
Trade balance (in percent of GDP)	-11.0	-9.0	-10.3	-10.8	-10.2	-11.4	-11.2
Current account, excl. grants (in percent of GDP)	-4.3	-2.4	-3.1	-3.4	-2.1	-3.2	-3.0
Terms of trade (deterioration -)	1.2	3.3	-3.6	-2.7	0.0	-0.1	0.0
Real effective exchange rate (depreciation -) 1/	2.2	0.7	-0.1	-0.1	1.0	-0.7	0.0
	(In percent of GDP)						
Consolidated central government 2/							
Revenue, excluding grants	29.9	30.3	28.4	29.1	28.9	29.1	27.8
Total expenditure and net lending	34.5	35.5	32.6	32.0	31.5	32.0	30.6
Consolidated balance, excl. grants and privatization	-4.5	-5.1	-4.2	-2.8	-2.6	-2.9	-2.8
Consolidated balance, incl. grants and privatization	-4.1	-4.9	-3.8	-0.6	-2.3	-1.7	1.0
Total government debt (foreign and domestic)	58.4	60.6	62.5	58.4	55.4	53.8	48.1
	(Annual percent change; unless otherwise indicated)						
Money and credit							
Credit to the economy	10.4	11.3	10.0	8.7	8.4	7.5	8.5
Broad money (M3)	6.9	13.1	14.2	6.0	18.6	10.4	9.1
Velocity of circulation (GDP/M3)	2.0	2.0	1.9	1.9	1.8	1.8	1.8
Liquidity aggregate (M4)	10.6	12.4	8.7	9.3	9.4	5.1	5.0
Velocity of circulation (GDP/M4)	1.5	1.5	1.5	1.5	1.5	1.6	1.6
Interest rate (money market rate, in percent)	8.8	7.8	6.9	6.9	5.9	5.9	...
Official reserves							
Gross official reserves (in billions of US$, end-period)	1.6	1.9	2.0	1.9	2.3	2.2	2.6
In months of imports of goods, c.i.f.	2.5	3.1	3.1	2.6	3.4	3.0	3.3
Total external debt							
External debt (in billions of US$)	11.2	11.4	11.1	11.6	11.8	11.4	11.2
External debt (in percent of GDP)	62.1	59.7	60.7	56.7	59.3	57.0	52.2
Debt service ratio 3/	20.9	21.4	19.4	19.2	18.6	22.4	16.5
Financial market indicators							
Stock market index 4/	635	571	456	465	811	1,434	...
Memorandum items:							
GDP at current prices (in billions of US$)	18.0	19.6	18.9	19.9	20.9	20.1	21.6
Exchange rate: dinar/US$ (average period)	0.95	0.97	1.11	1.14	1.19	1.34	1.37

Sources: Data provided by the Tunisian authorities; includes Fund staff projections for 2000 and 2001.

1/ Information Notice System; for 2000, average of first ten months.
2/ Includes the social security accounts.
3/ In percent of exports of goods and nonfactor services.
4/ For 2000: December 29, 2000.

Table 2. Tunisia: Balance of Payments, 1994-2000

(In millions of U.S. dollars)

	1994	1995	1996	1997	1998	1999	Proj. 2000
Current account	-654	-777	-479	-593	-676	-442	-636
Trade balance	-1,567	-1,988	-1,761	-1,955	-2,154	-2,138	-2,286
Exports	4,643	5,469	5,519	5,559	5,733	5,864	5,992
Energy	437	462	578	503	367	419	668
Nonenergy	4,206	5,007	4,940	5,057	5,366	5,445	5,324
Imports	-6,210	-7,458	-7,280	-7,514	-7,887	-8,003	-8,278
Energy	-466	-541	-607	-597	-396	-540	-843
Nonenergy	-5,744	-6,917	-6,673	-6,918	-7,491	-7,462	-7,435
Services and transfers (net)	913	1,212	1,283	1,362	1,478	1,696	1,650
Nonfactor	1,245	1,396	1,563	1,528	1,555	1,741	1,662
Of which:							
Tourism	1,302	1,399	1,452	1,415	1,506	1,641	1,548
Factor services and transfers (net)	-332	-184	-281	-166	-77	-45	-11
Of which:							
Workers' remittances	688	753	820	765	793	858	801
Interest payments on external debt	-516	-605	-661	-535	-544	-541	-553
Capital and financial account	1,218	928	838	710	621	878	568
Grants	103	46	46	95	82	73	30
Direct foreign investment (net)	455	308	262	388	685	357	651
Medium and long-term loans (net)	578	540	472	484	-175	491	-113
Disbursement	1,491	1,577	1,506	1,481	857	1,524	1,249
Amortization	-913	-1,038	-1,034	-997	-1,032	-1,033	-1,362
Short-term capital, valuation adjustments, and errors	82	35	58	-256	29	-42	0
Overall balance	564	151	359	117	-55	436	-68
Changes in official NFA	-564	-151	-359	-117	55	-436	68
Use of IMF resources	0	-15	-47	-50	-50	-50	-40
Other assets, net (increase -)	-564	-136	-313	-67	104	-386	108
Memorandum items:							
Current account balance/GDP (percent)	-4.2	-4.3	-2.4	-3.1	-3.4	-2.1	-3.2
Reserves (billions US$)	1.5	1.6	1.9	2.0	1.9	2.3	2.2
Reserves in months of imports	2.6	2.5	3.1	3.1	2.6	3.4	3.0
External MLT debt (billions US$)	8.8	9.8	9.9	9.6	10.0	10.3	9.8
External MLT debt/GDP (percent)	55.5	54.9	51.8	52.8	48.7	51.9	49.3
External short-term debt (billions US$)	1.1	1.3	1.5	1.5	1.6	1.6	1.6
External ST debt/GDP (percent)	7.2	7.2	7.8	7.9	8.0	7.4	7.7
Debt service ratio (as percentage XGS, incl. IMF)	20.7	20.9	21.4	19.4	19.2	18.6	22.4
Real export growth (in percent)	18.3	3.0	-2.4	10.1	6.3	6.7	6.4
Nonenergy	21.0	2.9	-3.6	12.9	7.0	5.6	7.3
Real import growth (in percent)	-1.1	6.3	-2.5	8.7	5.4	5.8	7.1
Nonenergy	-2.2	6.2	-2.2	9.0	7.2	4.1	8.0

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

Table 3. Tunisia: Consolidated Central Government, 1996–2001 1/

	1996	1997	1998	1999	Budget 2000 2/	Proj. 2000	Budget 2001
	(In millions of Tunisian dinars)						
Total revenue	5,786	5,933	6,579	7,180	7,625	7,837	8,208
Tax revenue	3,780	4,231	4,770	5,207	5,624	5,832	6,105
Of which:							
Income taxes	893	1,113	1,294	1,387	1,552	1,607	1,670
VAT	1,008	1,170	1,443	1,625	1,762	1,797	1,896
Trade taxes	782	736	751	731	754	754	724
Social security contributions	996	993	1,114	1,220	1,322	1,361	1,368
Nontax revenue	1,010	709	695	753	679	644	735
Total expenditure and net lending	6,764	6,804	7,223	7,828	8,572	8,623	9,033
Total expenditure	6,675	6,618	7,115	7,866	8,544	8,454	9,051
Current expenditure	5,362	5,283	5,644	6,153	6,620	6,530	6,936
Wages and salaries	1,969	2,320	2,533	2,930	3,126	3,126	3,397
Goods and services	465	399	415	395	587	536	596
Interest payments	825	720	692	840	870	870	910
Transfers and subsidies	2,103	1,843	2,004	1,989	1,922	1,883	2,033
Of which:							
Social security benefits	953	946	1,076	1,223	1,395	1,355	1,463
Other expenditure (not allocated)	0	0	0	0	116	116	0
Capital expenditure	1,313	1,335	1,471	1,713	1,924	1,924	2,115
Direct investment	902	955	1,408	1,078	1,196	1,196	1,341
Capital transfers and equity	411	381	63	635	728	728	774
Net lending	89	186	108	-38	27	169	-18
Consolidated deficit (-), excluding grants, privatization	-978	-871	-644	-648	-947	-786	-825
Grants	42	66	89	83	111	0	99
Privatization proceeds	10	3	418	1	150	341	1,022
Consolidated deficit (-), including grants, privatization	-926	-803	-136	-564	-686	-445	296
Financing	926	803	136	564	686	445	-296
Foreign	526	492	4	350	200	200	-440
Domestic	400	311	132	214	486	245	144
	(In percent of GDP)						
Total revenue	30.3	28.4	29.1	28.9	27.9	29.1	27.8
Tax revenue	19.8	20.2	21.1	21.0	20.6	21.7	20.7
Of which:							
Income taxes	4.7	5.3	5.7	5.6	5.7	6.0	5.7
VAT	5.3	5.6	6.4	6.5	6.5	6.7	6.4
Trade taxes	4.1	3.5	3.3	2.9	2.8	2.8	2.5
Social security contributions	5.2	4.8	4.9	4.9	4.8	5.1	4.6
Nontax revenue	5.3	3.4	3.1	3.0	2.5	2.4	2.5
Expenditure and net lending	35.5	32.6	32.0	31.5	31.4	32.0	30.6
Current expenditure	28.1	25.3	25.0	24.8	24.3	24.3	23.5
Wages and salaries	10.3	11.1	11.2	11.8	11.4	11.6	11.5
Goods and services	2.4	1.9	1.8	1.6	2.1	2.0	2.0
Interest payments	4.3	3.4	3.1	3.4	3.2	3.2	3.1
Transfers and subsidies	11.0	8.8	8.9	8.0	7.0	7.0	6.9
Of which:							
Social security benefits	5.0	4.5	4.8	4.9	5.1	5.0	5.0
Other expenditure (not allocated)	0.0	0.0	0.0	0.0	0.4	0.4	0.0
Capital expenditure	6.9	6.4	6.5	6.9	7.0	7.1	7.2
Net lending	0.5	0.9	0.5	-0.2	0.1	0.6	-0.1

Table 3. Tunisia: Consolidated Central Government, 1996–2001 (Concluded) 1/

	1996	1997	1998	1999	Budget 2000 2/	Proj. 2000	Budget 2001
				(In percent of GDP)			
Consolidated deficit (-), excluding grants, privatization	-5.1	-4.2	-2.8	-2.6	-3.5	-2.9	-2.8
Grants	0.2	0.3	0.4	0.3	0.4	0.0	0.3
Privatization proceeds (net)	0.1	0.0	1.9	0.0	0.5	1.3	3.5
Consolidated deficit (-), including grants, privatization	-4.9	-3.8	-0.6	-2.3	-2.5	-1.7	1.0
Memorandum items:							
Budget balance (excl. soc. sec., grants and priv.)	-6.1	-4.6	-3.6	-3.9	-3.7	-3.4	-3.2
Budget primary balance (excl. soc. sec., grants and priv.)	-1.8	-0.8	-0.2	-0.5	-0.5	-0.2	-0.1
Government debt 3/	60.6	62.5	58.4	55.4	53.0	53.8	48.1
Domestic	24.1	23.7	22.9	22.5	21.4	21.7	20.3
External	36.6	38.8	35.5	32.9	31.6	32.1	27.8

Sources: Tunisian authorities; and Fund staff estimates.

1/ Includes special funds, fonds de concours, and the social security system (except where indicated).
2/ For 2000, ratios as a share of GDP based on authorities' budget estimate of GDP; different from staff estimate of GDP for 2000.
3/ Gross debt: includes debt held by social security funds.

Table 4. Tunisia: Central Bank Balance Sheet, 1996–2000

	1996	1997	1998	1999	2000 Aug.
	(In millions of dinars; end of period)				
Foreign assets	1,938	2,304	2,080	2,895	2,745
International reserves (gold, SDRs, foreign exchanges)	1,918	2,282	2,058	2,871	2,721
Other foreign assets 1/	20	22	21	23	25
Claims on government 2/	103	58	78	79	83
Claims on development banks	4	0	0	0	0
Claims on other private sector	969	888	807	727	727
Claims on deposit money banks	154	93	93	93	404
Assets = Liabilities	3,168	3,343	3,058	3,793	3,959
Reserve money	2,264	2,446	2,187	2,840	2,811
Currency outside banks	1,472	1,592	1,695	1,994	2,147
Currency with banks	84	78	84	96	136
Banks' deposits	673	734	363	707	497
Claims of development banks and other fin. inst.	34	40	42	41	29
Demand deposits	1	1	2	2	2
Term deposits	33	39	41	39	26
Deposits of nonbank public	1	2	2	2	2
Foreign liabilities	272	255	174	180	148
Government deposits and currency holdings	254	232	242	243	444
Counterpart funds	47	67	80	81	161
Allocation of SDRs	49	53	53	59	63
Capital accounts	84	89	98	44	54
Other items (net)	198	201	224	346	278

Source: Banque Centrale de Tunisie.

1/ Excludes discounted claims on non residents.
2/ Excludes subscription to IMF/AMF considered by CBT as claim on government.

Table 5. Tunisia: Monetary Survey, 1996–2001 1/

	1996	1997	1998	1999	Projections 2000	2001
	(In millions of dinars; end of period)					
Foreign assets (net)	1,137	1,538	1,373	1,842	2,052	2,382
Foreign assets	2,550	3,075	2,881	3,776	...	...
Foreign liabilities	-1,413	-1,537	-1,508	-1,934	...	...
Net domestic assets	8,481	9,443	10,266	11,965	13,184	14,241
Domestic credit	13,685	15,306	16,454	18,380	20,141	21,810
Credit to the government (net)	963	1,314	1,251	1,896	2,423	2,591
Credit to the economy	12,722	13,992	15,203	16,484	17,718	19,219
Other items (net)	-5,204	-5,863	-6,188	-6,415	-6,957	-7,569
Money plus quasi-money (M2)	8,764	10,162	10,726	12,816	14,194	15,565
Money	3,981	4,474	4,790	5,554	...	...
Currency	1,473	1,594	1,695	1,994	...	...
Demand deposits	2,509	2,880	3,095	3,560	...	...
Quasi-money	4,783	5,688	5,936	7,262	...	...
Long-term deposits	854	819	913	991	1,042	1,058
Broad money (M3) 2/	9,618	10,981	11,639	13,806	15,236	16,623
Liquid treasury bills	2,243	2,066	2,525	1,800	920	300
Short-term commercial paper	631	530	673	627	907	1,000
Liquidity aggregate (M4) 3/	12,492	13,576	14,836	16,234	17,063	17,923
	(Annual rate of change in percent)					
Foreign assets (net)	33.2	35.2	-10.7	34.1	11.4	16.1
Domestic credit	12.7	11.8	7.5	11.7	9.6	8.3
Credit to government (net)	-4.0	36.4	-4.8	51.5	27.8	6.9
Credit to the economy	14.2	10.0	8.7	8.4	7.5	8.5
Money and quasi-money (M2)	13.9	15.9	5.6	19.5	10.8	9.7
Broad money (M3)	13.9	14.2	6.0	18.6	10.4	9.1
Liquidity aggregate (M4) 2/	13.0	8.7	9.3	9.4	5.1	5.0
	(Changes in percent of initial stock of M3)					
Foreign assets (net)	3.4	4.2	-1.5	4.0	1.5	2.2
Domestic credit	18.2	16.9	10.5	16.5	12.8	11.0
Credit to the government (net)	-0.5	3.6	-0.6	5.5	3.8	1.1
Credit to the economy	18.7	13.2	11.0	11.0	8.9	9.9
Other items (net)	-7.7	-6.8	-3.0	-2.0	-3.9	-4.0
Memorandum items:						
Velocity (GDP/M2)	2.18	2.06	2.11	1.94	1.90	1.89
Velocity (GDP/M3)	1.98	1.90	1.94	1.80	1.77	1.77
Velocity (GDP/M4)	1.53	1.54	1.52	1.53	1.58	1.65
Multiplier (M2/M0)	3.87	4.15	4.91	4.51	...	...
GDP (million dinars)	19,066	20,901	22,599	24,844	26,923	29,483
Nominal GDP growth (percent)	11.8	9.6	8.1	9.9	8.4	9.5

Sources: Banque Centrale de Tunisie; and Fund staff estimates and projections.

1/ Monetary survey data includes development banks.
2/ M2 plus long-term deposits.
3/ M3 plus liquid treasury bills (*bons cessibles*) and short-term commercial paper (*billets de trésorerie*).

Table 6. Tunisia: Commercial Banking System—Performance Indicators, 1994–99

	1994	1995	1996	1997	1998	1999
	(In percent unless otherwise indicated)					
Average return on assets						
Commercial banks	0.7	0.8	0.9	0.8	1.2	1.2
Private banks	0.8	1.0	1.1	0.9	1.4	1.4
Public banks	0.6	0.7	0.7	0.7	1.0	1.0
Development banks	1.5	1.3	1.4	1.4	1.6	2.1
Average return on equity						
Commercial banks	15.5	16.8	17.9	17.3	19.4	26.0
Private banks	25.9	27.9	31.0	22.0	24.9	26.7
Public banks	11.9	12.3	12.8	14.0	15.5	25.1
Development banks	7.2	5.7	6.0	5.9	6.9	9.3
Capital adequacy ratio 1/						
Commercial banks	3.7	4.6	5.1	6.3	8.9	10.1
Private banks	8.5	10.5	9.4	6.8	8.9	10.4
Public banks	2.1	2.2	3.4	5.9	8.8	9.8
Development banks	32.0	32.6	30.8	33.3	36.3	39.1
Number of banks not respecting minimum capital adequacy ratio						
Commercial banks	5	5	5	3	2	1
Private banks	1	1	1	1	1	0
Public banks	4	4	4	2	1	1
Development banks	0	0	0	0	0	0
Problem loans/total commitments 2/	34.9	34.8	31.5	29.9	26.4	25.8
Commercial banks	31.4	30.8	25.1	23.0	19.5	18.8
Private banks	17.9	18.2	17.0	19.4	19.4	18.0
Public banks	37.7	36.8	29.3	25.8	19.6	19.5
Development banks	54.1	56.7	64.2	67.0	64.3	65.6
Provisions/problem loans	31.0	33.6	44.0	47.0	53.7	52.9
Commercial banks	29.5	32.0	46.7	50.4	59.7	58.5
Development banks	35.5	38.4	38.6	40.7	43.7	43.6
Unprovisioned problem loans/total capital						
Commercial banks	193.7	166.6	157.7	139.1	94.3	85.6
Development banks	110.3	110.8	134.4	131.3	123.4	123.5
Memorandum items:						
Total credit to the economy/GDP	66.0	67.1	63.2	62.7	63.7	63.4
Problem loans/GDP	29.1	29.3	24.9	23.9	21.4	20.3

Source: Banque Centrale de Tunisie.

1/ Risk weighted. Averages weighted by banks' capital (fonds propres nets).
2/ Total commitments include credits to clients plus other contingent items such as guarantees.

Table 7. Tunisia: Indicators of External Vulnerability, 1995–2001

	1995	1996	1997	1998	1999	Projections 2000	2001
Balance of payments							
Exports (percent change, 12-month basis in U.S. dollars)	17.8	0.9	0.7	3.1	2.3	2.2	6.8
Imports (percent change, 12-month basis in U.S. dollars)	20.1	-2.4	3.2	5.0	1.5	3.4	6.6
Exports of goods, f.o.b. (volume percent change)	3.0	-2.4	10.1	6.3	6.7	6.4	6.6
Imports of goods,f.o.b. (volume percent change)	6.2	-2.4	8.5	5.5	5.9	7.3	6.4
Terms of trade (percent change, 12-months basis)	1.2	3.3	-3.6	-2.7	0.0	-0.1	0.0
Trade balance (in percent of GDP)	-11.0	-9.0	-10.3	-10.8	-10.2	-11.4	-11.2
Current account balance (in percent of GDP)	-4.3	-2.4	-3.1	-3.4	-2.1	-3.2	-3.0
Capital and financial account balance (in percent of GDP)	5.1	4.3	3.8	3.1	4.2	2.8	3.9
Short-term foreign assets and liabilities of the banking and corporate sector							
Gross official reserves (billions of U.S. dollars)	1.6	1.9	2.0	1.9	2.3	2.2	2.6
Gross official reserves (in months of imports goods, cif)	2.5	3.1	3.1	2.6	3.4	3.0	3.3
Central bank short-term foreign liabilities (billions of U.S. dollars)	0.3	0.3	0.2	0.2	0.1	0.1	0.1
Short-term foreign assets of financial, corporate sectors (billions of U.S. dollars) 1/	0.4	0.6	0.6	0.7	0.6	0.6	0.6
Short-term foreign liabilities of financial, corporate sectors (billions of U.S. dollars) 1/	0.9	1.2	1.2	1.2	1.5	1.6	1.6
External debt and debt service							
External debt (billions of U.S. dollars)	11.2	11.4	11.1	11.6	11.8	11.4	11.2
Medium and long-term public debt (billions of U.S. dollars)	9.8	9.9	9.6	10.0	10.3	9.8	9.6
Short-term debt (billions of U.S. dollars)	1.3	1.5	1.5	1.6	1.6	1.6	1.7
Total external debt /GDP (percent)	62.1	59.7	60.7	56.7	59.3	57.0	52.2
Medium and long-term Public debt/GDP (percent)	54.9	51.8	52.8	48.7	51.9	49.3	44.3
Short-term debt/GDP (percent)	7.2	7.8	7.9	8.0	7.4	7.7	7.8
Total short-term external debt/reserves (percent) 2/	79.7	79.1	73.9	84.4	67.1	71.2	66.0
Short-term debt including current amortization/reserves (percent)	144.3	136.0	124.8	143.4	130.0	112.7	100.2
Debt service ratio (debt service as percent of exports GNFS)	20.9	21.4	19.4	19.2	18.6	22.4	16.5
External interest payments (as percent of exports GNFS)	7.4	8.1	6.6	6.4	6.2	6.3	6.2
External amortization payments (as percent of exports GNFS)	13.5	13.3	12.9	12.8	12.4	16.0	10.3
Exchange rate (per U.S. dollar, period average)	0.95	0.97	1.11	1.14	1.19	1.34	1.37
REER appreciation (+, percent change 12 months basis) 3/	2.2	0.6	-0.1	-0.1	1.0	-0.7	0.0
Financial market indicators							
Stock market index (9/30/90 = 100) 4/	635	571	456	465	811	1,434	...
Foreign currency debt rating 5/	BBB-	BBB-	BBB-	BBB-	BBB-	BBB	...
Spread of benchmark bonds (basis points, end of period) 6/ 7/	...	...	140-180	470-530	250	130	...

Source: Tunisian authorities, and Fund Staff estimates.

1/ Excludes monetary authorities. Refers to financial assets and liabilities only.
2/ Short-term defined as 1 year and less.
3/ Information Notice System. For 2000, projection based on average of first nine months of 2000.
4/ For 2000: December 29, 2000
5/ S&P long-term foreign currency rating - upgraded to BBB in March 2000.
6/ Spreads of the 10 and 30 year Yankee bonds above U.S. treasury.
7/ For 2000, spread over LIBOR of the August, 2000 Yen Samurai bond issue.

Table 8. Tunisia: Medium-Term Growth Scenario, 2000-06

	2000	2001	2002	2003	2004	2005	2006
				(In percent)			
Real GDP growth	5.0	6.2	6.1	6.3	6.5	6.6	6.7
Agriculture 1/	-1.0	6.5	4.5	4.5	4.5	4.5	4.5
Nonagriculture	6.0	6.2	6.4	6.6	6.8	6.9	7.0
Unemployment rate	15.5	14.9	14.3	13.7	12.9	12.0	10.9
Inflation	3.0	2.9	2.7	2.7	2.2	2.2	2.1
Real export growth 2/	5.9	6.4	5.7	6.7	5.9	6.5	6.5
				(In percent of GDP)			
Gross national savings	24.6	25.0	25.4	26.1	26.6	27.2	27.7
Central government	4.9	5.3	5.5	5.8	6.1	6.4	6.8
Rest of the economy	19.8	19.7	19.9	20.2	20.5	20.8	21.0
Gross investment	27.7	27.9	28.4	28.8	29.6	30.1	30.7
Central government	4.4	4.5	4.5	4.5	4.5	4.5	4.5
Rest of the economy	23.3	23.4	23.9	24.3	25.1	25.6	26.2
Savings-investment gap	-3.1	-2.9	-3.0	-2.8	-3.0	-2.9	-3.0
Central government	0.4	0.8	1.0	1.3	1.6	1.9	2.3
Rest of the economy	-3.5	-3.7	-4.0	-4.1	-4.6	-4.8	-5.2
Memorandum items:							
Balance of the consolidated central government 3/	-2.9	-2.5	-2.2	-2.0	-1.7	-1.4	-1.0
External current account	-3.1	-2.9	-3.0	-2.8	-3.0	-2.9	-3.0
Gross fixed capital formation	26.2	26.3	26.8	27.2	28.0	28.6	29.2

Source: IMF staff estimates from 2001.

1/ Based on average growth of agricultural output from 2001 onwards.
2/ Goods and nonfactor services.
3/ Includes the social security system and grants, excludes privatization proceeds.

Table 9. Tunisia: Balance of Payments, 1999-2006

(In millions of U.S. dollars)

		Projections						
	1999	2000	2001	2002	2003	2004	2005	2006
Current account	-442	-636	-650	-708	-692	-788	-838	-914
Trade balance	-2,138	-2,286	-2,423	-2,654	-2,851	-3,162	-3,446	-3,774
Exports	5,864	5,992	6,400	6,861	7,507	8,160	8,929	9,754
Energy	419	668	668	597	586	592	598	598
Non-energy	5,445	5,324	5,732	6,264	6,921	7,568	8,331	9,156
Imports	-8,003	-8,278	-8,824	-9,515	-10,358	-11,322	-12,375	-13,528
Energy	-540	-843	-864	-821	-859	-927	-1,001	-1,071
Non-energy	-7,462	-7,435	-7,960	-8,694	-9,499	-10,395	-11,374	-12,457
Services and transfers (net)	1,696	1,650	1,774	1,946	2,159	2,374	2,608	2,861
Nonfactor	1,741	1,662	1,788	1,951	2,140	2,331	2,548	2,782
Of which:								
Tourism	1,641	1,548	1,649	1,792	1,945	2,111	2,289	2,483
Factor services and transfers (net)	-45	-11	-15	-5	19	43	60	78
Of which:								
Workers' remittances	858	801	822	862	903	951	1,001	1,054
Interest payments on external debt	-541	-553	-578	-573	-560	-561	-573	-587
Capital and financial account	878	568	835	737	746	870	926	1,010
Grants	73	30	132	95	98	102	106	110
Direct foreign investment (net)	357	651	897	915	691	616	639	663
Medium and long-term loans (net)	491	-113	-194	-273	-44	151	181	236
Disbursement	1,524	1,249	702	599	800	1,269	1,302	1,364
Amortization	-1,033	-1,362	-896	-873	-843	-1,118	-1,121	-1,127
Short-term capital, valuation adjustments, and errors	-42	0	0	0	0	0	0	0
Overall balance	436	-68	185	29	54	82	88	96
Changes in official NFA	-436	68	-185	-29	-54	-82	-88	-96
Use of IMF resources	-50	-40	-27	-6	0	0	0	0
Other assets, net (increase -)	-386	108	-159	-23	-54	-82	-88	-96
Memorandum items:								
Current account balance/GDP (percent)	-2.1	-3.2	-3.0	-3.0	-2.7	-2.8	-2.7	-2.7
Reserves (billions of US$)	2.3	2.2	2.6	2.7	3.0	3.3	3.6	3.9
Reserves in months of imports	3.4	3.0	3.3	3.3	3.3	3.3	3.3	3.3
External medium and long-term debt (billions of US$)	10.3	9.8	9.6	9.3	9.3	9.4	9.6	9.8
External MLT debt/GDP (percent)	51.9	49.3	44.3	39.5	36.0	33.5	31.2	29.2
External short-term debt (billions of US$)	1.6	1.6	1.7	1.8	2.0	2.2	2.4	2.6
External short-term debt/GDP (percent)	7.4	7.7	7.8	7.8	7.8	7.8	7.8	7.8
Debt service ratio (as percent XGS, incl. IMF)	18.6	22.4	16.5	14.9	13.3	14.7	13.5	12.5
Real export growth (in percent)	6.7	6.4	6.6	5.7	6.8	5.9	6.7	6.6
Non-energy	5.6	7.3	6.9	6.4	7.7	6.6	7.4	7.2
Real import growth (in percent)	5.8	7.1	6.4	6.4	6.6	6.7	6.8	6.9
Non-energy	4.1	8.0	6.4	6.4	6.5	6.7	6.8	6.9

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

Table 10. Tunisia: Basic Social and Demographic Indicators, 1980–98

	1980	1985	1994	1998	MENA Countries 1998	All Lower Middle Income Countries 1998
Population characteristics						
Total population (in millions)	6.4	7.3	8.8	9.3	285.7	886.5
Urban population (in percent of total population)	52	54	61	64	57	58
Birth rate (per thousand)	35	29 1/	23	18	27	20
Death rate (per thousand)	9	7 1/	6	6	7	9
Life expectancy at birth (years)	62	66 1/	71	72	68	68
Population growth (in percent)	2.7	3.0	1.7	1.3	2.1	1.1
Income and wages						
GDP per capita (in 1990 dinars)	1,215 2/	1,287	1,449	1,658	...	...
GDP per capita (in current dinars)	635 2/	966	1,791	2,421	...	...
GDP per capita at current prices (in US$)	1,286 2/	1,140	1,771	2,129	2,042	1,667
Minimum wage in the nonagricultural sector (SMIG in current dinars per hour)	0.30 2/	0.46	0.73	0.86	...	...
Poverty incidence (headcount index, in percent of households)	13	8	6 3/	...	...	...
Health						
Infant mortality (per thousand live births)	69	52 1/	32	28	45	35
Population per physician	3,694	2,170 4/	1,754	1,380	4,235 5/	4,287 5/
Education						
Literacy rate (in percent)	45	53	64	69	63	86
Of which:						
Female	31	39	52	58	52	83
Primary enrollment (gross, in percent of school age population)	102	115	117	118 6/	95 7/	103.0 3/
Secondary enrollment (gross, in percent of school age population)	27	39	57	64 6/	64 7/	67.0 3/
Pupils per teacher (primary school)	39	32	25	24 7/	26 7/	25.0 8/
Labor force						
Total labor force (in millions)	2.2	2.5	3.3	3.6	93.8	385.6
Unemployment rate (in percent)	12.9	16.1	15.6	15.9	...	...

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

1/ Data for 1987.
2/ Data for 1981.
3/ Data for 1995.
4/ Data for 1986.
5/ Data for 1981.
6/ Data for 1997.
7/ Data for 1996.
8/ Data for 1993.

TUNISIA: FUND RELATIONS

(As of December 31, 2000)

I. **Membership Status:** Joined: 04/14/1958; Article VIII

II. **General Resources Account:**	SDR Million	Percent of Quota
Quota	286.50	100.0
Fund holdings of currency	291.08	101.6
Reserve position in Fund	20.17	7.0

III. **SDR Department:**	SDR Million	Percent of Allocation
Net cumulative allocation	34.24	100.0
Holdings	2.97	8.7

IV. **Outstanding Purchases and Loans:**	SDR Million	Percent of Quota
Extended arrangements	24.74	8.6

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
EFF	07/25/1988	07/24/1992	207.30	207.30
Stand-by	11/04/1986	05/31/1988	103.65	91.00

VI. **Projected Obligations to Fund:** (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	07/31/2000	2001	2002	2003	2004	2005
Principal		20.2	4.5	...	...	...
Charges/interest		2.2	1.5	1.4	1.4	1.4
Total		22.4	6.0	1.4	1.4	1.4

A. Exchange Rate Arrangement and Exchange System

Tunisia accepted the obligations of Article VIII Sections 2,3, and 4 effective January 6, 1993 and maintains an exchange system that is free of restrictions on the making of payments and transfers on current international transactions, except for certain restrictions relating to Iraq and the Federal Republic of Yugoslavia (Serbia and Montenegro), pursuant to UN Security Council Resolutions. These are subject to notification to the Fund in accordance with Decision 144 (52/51), but Tunisia has not yet notified the Fund in this regard. Tunisia also maintains a multiple currency practice resulting from honoring exchange rate guarantees extended prior to August, 1988 to development banks. Following the loss of the original record of these guarantees, litigation led to an agreement whereby the guarantees will expire in 2000 and 2001.

The Central Bank of Tunisia sets daily official exchange rates for the dinar with a view to keeping the real effective exchange rate broadly contant. Since March 1, 1994, the market rates are determined in an interbank foreign exchange market. On January 18, 2001, the interbank rate of the dinar vis-à-vis the U.S. dollar was US$1=TD 1.38, equivalent to SDR 1=TD 1.79.

Article IV Consultation

Tunisia is on the 12-month cycle. The last discussions of the Article IV consultation were held in Tunis during June 3-16, 1999 and the consultation was concluded by the Executive Board on September 2, 1999. The 2000 consultation was held in Tunis later in the calendar year, during October 18-30, in order for the Article IV discussions to coincide with the annual budget cycle and with the preparation of the macroeconomic framework for the authorities' next five-year development plan (2002-06).

Technical Assistance

- October 4–21, 1994: FAD—review of tax system.
- September 19–October 7, 1994 and December 5–14, 1994: MAE—expert in area of monetary programming.
- January 31–February 14, 1996: FAD—assessment of revenue impact of Association Agreement with EU.
- March 31–April 4, 1997: STA—introduction of new methodological guidelines according to fifth edition of *Balance of Payments Manual*.
- September 9–12, 1998: MAE—monetary management and development of the money market.
- May 10-21, 1999: STA—quarterly national accounts.
- May 13-18, 1999: STA—SDDS.
- October 12-15, 1999: MAE – Debt management practices.
- October 17-27, 2000: STA—SDDS (preparation of quarterly national accounts).
- October 25-31, 2000: STA—SDDS (finalization of metadata).

Resident Representative: None.

TUNISIA: RELATIONS WITH THE WORLD BANK GROUP

(As of November 30, 2000)

1. Since 1962, the World Bank has committed 10 International Development Agency (IDA) credits (net of cancellations) amounting to US$75 million, and 109 International Bank for Reconstruction and Development (IBRD) loans amounting to US$4,344 million, to Tunisia.

2. As of November 30, 2000 the sector shares of the Bank Group commitments were as follows: agriculture and environment (22 percent), industry, energy, mining, oil and gas (8 percent), transport, infrastructure, and water supply and sanitation (19 percent), education, health and nutrition (16 percent), urban development (7%) financial sector (11 percent), public sector management (4 percent), and multisector loans (13 percent).

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

4. In July 1996, the Bank approved the first of a series of Economic Competitiveness Adjustment Loan (ECAL I) to upgrade the private sector in preparation for the Free Trade Agreement signed with the EU in 1995 (AAEU). The main policy measures included in the ECAL I are as follows: (a) a sound macroeconomic and fiscal framework; (b) acceleration in the implementation of the free trade agreement; (c) acceleration of the privatization program; (d) greater flexibility in the labor market; and (e) administrative and regulator reforms. The second tranche of ECAL I was released in June 1998 following the acceleration of the privatization program, the removal of the government's monopoly of port handling and the completion of the restructuring plans for the state-owned shipping and stevedoring companies.

5. The second Economic Competitiveness Adjustment Loan (ECAL II) was approved by the Executive Board on April 20, 1999, for US$159 million. ECAL II aimed to support a program of reforms in the financial sector to supplement on-going reforms in the real sector. Project implementation has been generally satisfactory. However, the disbursement of the second tranche of the ECAL II, originally scheduled for fiscal year 2000, is likely to take place only this fiscal year due to delays in implementing key policy measures in banking sector liberalization and in the payment of non-performing loans of the public enterprises.

6. A third Economic Competitiveness Adjustment Loan (ECAL III) is being prepared during the current fiscal year, for consideration by the Executive Board in June 2001. ECAL III will include broad macroeconomic reforms as well as measures in the financial sector area.

7. The Bank's program in Tunisia during the current Country Assistant Strategy (CAS) period (fiscal years 2001 to 2003) will support:

8. **Consolidating long-term development** through activities in sectors of traditional World Bank involvement, mainly human resource development, natural resource management, transport, and rural and urban development;

9. **Supporting economic reforms** to enhance competitiveness and increase employment, with safeguards against transitional costs of adjustments;

10. **New initiatives** of a catalytic nature to strengthen local institutions, launch new development niches (e.g., information technology), and mobilize external finance.

Tunisia: World Bank Loans and Debt Service, 1994-2001 (Fiscal Years)

(In millions of U.S. dollars)

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000
Commitments	267.5	272.8	98.7	241.5	222.0	194.0	202.0
Investment projects	267.5	272.8	98.7	166.5	222.0	35.0	202.0
Adjustment loans	0.0	0.0	00	75	0.0	159.0	0.0
Disbursements	169.2	209.3	141.6	202.8	132.7	208.6	147.1
Investment projects	93.9	127.2	140.5	165.3	100.3	137.3	147.1
Adjustment loans	75.3	82.1	1.1	37.5	32.4	71.3	0.0
Total debt service	275.3	327.2	323.4	283.1	277.5	270.6	246.5
Amortization	154.9	199.3	198.7	174.9	180.9	175.9	163.1
Interest and charges	120.4	127.9	124.7	108.2	96.6	94.7	83.4

Sources: World Bank Loan Kiosk, Integrated Controller's System.

TUNISIA: STATISTICAL ISSUES

1. Available economic and financial data have generally been provided to the Fund on a regular and timely basis; most of those data are also made available to the wider public. The authorities made substantial progress in 1999 and 2000 in their efforts to subscribe to the SDDS, although there is scope for further improvements in the coverage and timeliness of economic data to enhance analysis and policy formulation, particularly as regards the operations and financial positions of public enterprises. While Tunisia committed to subscribing to the SDDS by end-2000, formal subscription is expected to take place by mid-2001 to allow time for additional improvements in the areas of quarterly national accounts and labor market statistics, and to meet SDDS dissemination and timeliness requirements in a number of other areas. In addition, advance release calendars in all the necessary categories need to be prepared and disseminated – the authorities plan to do so by February, 2001. Two STA missions in October, 2000 assisted the authorities with issues related to SDDS subscription, and the authorities have requested the continued assistance of STA until formal subscription.

Real Sector

2. IFS coverage of data on real sector developments is satisfactory and most data are reported in a timely manner, although export and import price and volume indices are reported with a long lag. While labor market statistics are now produced on an annual basis compared to the previous collection in five year survey intervals, quarterly reporting is required under the SDDS. Data on wages/earnings are still being developed and are scheduled to be distributed by February 2001. The timeliness requirement under the SDDS for the production index also exceeds the SDDS standards (eight weeks instead of six). While quarterly national accounts data are not disseminated as yet, the National Institute of Statistics is in the process of finalizing the data. A technical assistance mission on the subject which took place in October, 2000 reviewed the methodology and concluded that, although further work is required, Tunisia should be able to meet SDDS standards by April 2001. STA recommended that formal subscription to the SDDS could occur after the publication of the quarterly national accounts data scheduled for April 2001.

Government Finance

3. Government finance data are collected by the staff at the time of the Article IV consultation mission. SDDS data for general and central government operations and debt and government interest rates are currently available but are not yet disseminated. These data are scheduled to be disseminated in February, 2001. GFS data up to 1996 are published in the *Government Finance Statistics Yearbook* 1999. Data cover consolidated central government. Tunisia does not report monthly or quarterly data for publication in IFS.

Balance of Payments

4. Balance of payments statistics are generally adequate for surveillance, although greater detail on the financial account would be desirable. Balance of payments data are compiled on a monthly cumulative basis instead of the quarterly basis prescribed in the SDDS. The authorities are planning to rectify this in December 2000. Data required for the SDDS reserves template on international reserves, foreign currency liquidity and forward exchange rates are currently available, although their dissemination is scheduled to begin only in February 2001. The timeliness requirement for gross international reserves (one week instead of Tunisia's six weeks) has not yet been met, although the authorities also plan to correct this by the time of subscription.

Money and Banking

5. Money and banking statistics are adequate for surveillance. As regards SDDS, data on the analytical accounts of the central bank currently do not meet the timeliness requirement (three months instead of two weeks). This will also be corrected by next spring.

TUNISIA: CORE STATISTICAL INDICATORS

(As of January 15, 2001)

	Exchange Rate	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rate	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt and Debt Service
Date of latest observation	10/1/00	11/30/00	11/30/00	11/30/00	11/30/00	12/31/00	Nov. 2000	Nov. 2000	1999	1999	1999	1999
Date received	11/1/00	1/5/01	1/5/01	1/5/01	1/1/01	01/17/01	1/17/01	Dec. 2000	Dec. 2000	Oct. 2000	Oct. 2000	Oct. 2000
Frequency of data	M	M	M	M	M	M	M	A	A	A	A	A
Frequency of reporting	M/V	M/Q/V	M/Q/V	M/Q/V	M/V	M	M/V	M/V	Q/V	V	V	V
Source of data	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank/ Internet	Central Bank/ Internet	INS/ Internet	Central Bank/ Internet	Central Bank/ Internet	Ministry of Finance	Ministry of Econ. Dev.	Central Bank
Mode of Reporting	Cable	Fax/ Central Bank Bulletin	Fax/ Central Bank Bulletin	Fax/ Central Bank Bulletin	STA rept./ Fax	STA rept./ Mission	STA rept./ Mission/ Fax	Mission/ Annual Report/ Fax	Mission	Fax/ Mission	Mission	Mission/ Fax
Confidentiality	U	U	U	U	U	U	U	U	U	U	U	U
Frequency of publication	M	M	M	M	M	M	M	Q	Q	A	Q	Q

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

Statement by the IMF Staff Representative
February 7, 2001

This statement provides information that was recently received by the staff. It does not change the thrust of the staff appraisal contained in the Staff Report for the 2000 Article IV Consultation for Tunisia. (SM/01/17, 1/19/01).

1. As indicated to staff during the mission, the central bank recently made changes in its financing windows so as to introduce greater flexibility into the interbank interest rate. Specifically, the central bank ended automatic access to its end-of-day financing facility and introduced a spread of 1/8 of 1 percent between the lending and borrowing rates on the end-of-day operations. It also reduced the amount of liquidity that it injects through 7-day auctions, in favor of the more expensive repurchase facility. Some movement has been observed in the interbank rate around the official intervention rate since the introduction of these measures.

2. The central bank has revised its estimate of the external current account deficit for 2000 to 3.8 percent of GDP (instead of 3.2 percent). The revision stems mostly from a weakening in the non-factor service balance. Combined with the delay in the disbursement on the last tranche of the World Bank's ECAL II, this resulted in a decline of foreign exchange reserves to US$1.8 billion in December 2000, compared to a projected level of US$2.2 billion. Due to a slight worsening in international borrowing conditions in the closing months of 2000, the authorities refrained from tapping the international bond market to make up for this shortfall, although short-term financing (18 months) of Yen 10 billion was raised in December through a private placement. This information confirms the staff's view that the external accounts merit close monitoring and reinforces the recommendation that reserve coverage of external current and capital liabilities be maintained at a more comfortable level.

3. On banking sector restructuring and privatization, the authorities confirmed that the planned merger of one of the three large public banks (STB) with two development banks (BDET and BNDT) has been completed, paving the way for the release of the last tranche of the World Bank's ECAL II . The government has also privatized *Lloyd Tunisien*, a medium-sized insurance company, and has announced the privatization of a smaller public bank (UIB) and the sale of its minority participation in another bank (*Banque du Sud*).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/13
FOR IMMEDIATE RELEASE
February 13, 2001

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

IMF Concludes Article IV Consultation with Tunisia

On February 7, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tunisia.[1]

Background

Real growth strengthened to an average rate of 5.7 percent between 1996 and 2000, as gradual economic liberalization and prudent macroeconomic policies allowed Tunisia to reap the benefits offered by stronger integration into the world economy. However, despite significant job creation, high labor force growth has left the unemployment rate roughly unchanged over this period at around 15 percent.

GDP growth has been robust in all sectors, particularly services and manufacturing, while domestic demand growth has been buoyed by rising real incomes and strong investment, particularly in the services and export-oriented manufacturing sectors. The growth performance in 2000 confirms recent favorable trends. Despite the negative impact of drought conditions, overall GDP growth should reach 5 percent in 2000. For 2001, growth should exceed 6 percent on the basis of an expected rebound in agricultural production.

Thanks to prudent monetary policy and an active incomes policy, annual inflation has remained stable at just under 3 percent in 2000, despite higher food and energy prices. During 1999 and 2000, the monetary authorities had to accommodate large portfolio shifts out of liquid treasury paper into time deposits, stemming from the phasing out of liquid treasury bills and their

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the February 7, 2001 Executive Board discussion based on the staff report.

replacement with auctioned bills and bonds. While this has led to a marked increase in the growth of broad money, there was little impact on real activity or interest rates since overall liquidity increased only moderately, and in line with the authorities' target. Growth in credit to the economy (private and public enterprises) has been kept slightly below nominal GDP growth.

The budget deficit target set for 2000 (3.7 percent of GDP) appears to have been comfortably met, as supplementary spending on petroleum price supports were more than offset by higher tax revenues. Including the social security surplus, the consolidated deficit is thus estimated at 2.9 percent of GDP in 2000. Thanks in part to large privatization proceeds (1.3 percent of GDP), government debt is estimated to have declined to 54 percent of GDP in 2000.

In the face of a weakening euro, the central bank departed from its fixed real exchange rate rule during 2000, allowing the dinar to depreciate slightly in real effective terms. Reflecting a rising investment rate, a deterioration in agricultural trade, a slowdown in the growth of tourism receipts and the rise in oil prices, the mission projected that the external current account deficit would rise to 3.2 percent of GDP—more recent information provided by the Central Bank of Tunisia puts the 2000 external current account deficit at 3.8 percent of GDP. A reversal of some of these factors should result in a narrowing of the external deficit in relation to GDP in 2001. Strong non-debt creating capital inflows linked to the privatization of a large state cement enterprise limited the external borrowing requirement in 2000. Consequently, medium and long-term external debt is estimated to have declined from 52 percent of GDP in 1999 to 49 percent of GDP. Riding on an improved credit rating (Standard & Poor's long-term foreign currency rating was upgraded to BBB in early 2000 and Moody's outlook went from "stable" to "positive"), the authorities tapped international financial markets at a much lower spread (130 basis points on a 10-year yen issue) than in 1999 (280 basis points on a 10-year euro issue).

Structural reforms have proceeded on several fronts, including banking sector reform, enterprise restructuring, and in developing the private sector. The privatization program was boosted by the sale of three major cement factories in 1998 and 2000, and a new privatization drive involving 41 public enterprises has been announced for 2001. Tunisia began reducing tariffs against EU manufactured goods in 1996, but overall trade protection remains high and significant restructuring is still needed to meet the challenges of free trade with the EU. In the past, weak lending practices and banking supervision resulted in the accumulation of a large stock of non-performing loans. Banking sector reforms and public enterprise restructuring have succeeded in reversing this trend, but bad loans still stood at 20 percent of GDP at the end of 1999, although over half of this amount is covered by loan loss provisions. Meanwhile, the state retains extensive control over the economy through a large public enterprise sector and controls on prices and market access. Tunisia's social indicators remain outstanding by regional standards, notably in terms of education, health provision, gender gaps and housing.

The authorities have increased the transparency of economic policies, including by committing to subscribe to the Special Data Dissemination Standard (SDDS), publishing the preliminary conclusions of the Article IV mission (see http://www.imf.org/external/np/ms/2000/102900.htm), and agreeing to publish the staff report. They will also participate in the IMF-World Bank's Financial Sector Assessment Program and Financial System Stability Assessment in 2001.

Executive Board Assessment

Executive Directors commended Tunisia's strong economic performance and social achievements, which they attributed to a combination of prudent macroeconomic policies, gradual liberalization, and progressive social policies. Directors noted with satisfaction that the sustained implementation of these policies has resulted in improved credit ratings and access to international capital markets.

Directors considered that Tunisia's growth and employment performance could improve further by stepping up the process of liberalization and transition to a fully open and market-driven economy. In this respect, they underscored the importance of complementing the ongoing trade liberalization with the European Union (EU) with comprehensive trade and price liberalization measures and sustained structural reforms.

Directors welcomed the importance which the authorities are attaching to maintaining macroeconomic stability as a prerequisite for growth and investment as well as to contain potential rising pressures on the external accounts. In this context, they encouraged the authorities to maintain the fiscal deficit on a downward path while improving the structure of the budget. While welcoming the efforts to contain the deficit in 2001, Directors believed that more ambitious deficit reduction targets should be set in the future in view of the favorable short-term growth prospects and to offset the structural deterioration in the social security accounts. They noted that the extensive system of tax exemptions and the high government wage bill are the main sources of budgetary rigidity, and therefore they stressed the need for reform of the civil service and the tax system. In view of the fact that these reforms take time to be implemented, work on them should be initiated as soon as possible. Some Directors also recommended accelerating the phasing out of generalized food subsidies given their inefficiency in terms of reaching the more vulnerable groups, but others stressed that the authorities' gradual approach had allowed them to maintain social stability. On medium-term fiscal challenges, Directors appreciated that the authorities are considering comprehensive reforms to place the social security system on a sound financial footing.

Directors commended the authorities for achieving and preserving price stability and noted the dual role played by incomes and monetary policies. They recommended that monetary policy take on a more explicit and central anchoring role for inflationary expectations in the future, and welcomed, in this regard, recent initiatives to increase transparency and announce monetary policy objectives. Directors also saw scope for increased reliance on interest rate signals in line with the improved financial situation of banks and the development of the treasury bill market.

Directors observed that the (CPI-based) real exchange rate target followed by the authorities has served the country well, but noted that this approach will become a less reliable indicator of competitiveness in the context of trade liberalization. In this light, they supported the central bank's recent decision to broaden the set of indicators used to guide exchange rate policy.

Directors stressed that structural reforms as well as sustained trade, price, and market liberalization hold the key to moving the economy to a higher growth path and delivering on the authorities' primary objective of reducing Tunisia's high unemployment rate. They commended the authorities for their efforts to prepare the private sector for stiffer competition and to open the service sector to private sector activity, notably in telecommunications and port activities. Directors particularly welcomed the recent plan to privatize 41 state enterprises over the coming 12 months, and encouraged the authorities to follow through with this program and plan further privatizations for 2002 and beyond.

Directors underscored the importance of ongoing trade liberalization with the EU as an important source of productivity gains and growth potential for the economy. They expressed concern about the potential serious trade distortions that could arise from the growing gap between the trade regime with the EU and the most favored nation (MFN) trade regime, and therefore urged the authorities to reduce MFN tariff rates at a faster pace.

Directors congratulated the authorities for the progress made in strengthening the banking sector, but noted that the large portfolio of nonperforming loans continues to weigh heavily on the economy. They agreed that, in addition to tight supervision and regulation, greater corporate transparency and improved risk analysis in the banking sector are needed to limit the risk of accumulating new bad loans. Directors noted that opening the banking sector to foreign investors would contribute to the reinforcement of risk management. They welcomed the authorities' decision to participate in the Financial Sector Assessment Program (FSAP) in 2001.

Directors considered that Tunisia would benefit from closer integration into world capital markets, but agreed that significant further liberalization of the financial account should wait until additional progress is made in strengthening the banking sector and deepening domestic capital markets.

On labor market policies, Directors welcomed the recent measures to improve job placement, training, and self-employment. They took note of recent indications that job creation is improving, but agreed that additional steps to eliminate labor market rigidities will be needed. While recognizing the positive contribution of the present wage-setting mechanism to price and social stability, Directors encouraged the authorities to find ways to allow productivity considerations to play a more prominent role in the wage-setting process across enterprises and sectors. They also recommended adapting labor market regulations to the needs of a more flexible labor market.

Directors welcomed the substantial improvements in the quality and dissemination of statistical information, and looked forward to the additional improvements which should result from Tunisia's subscription to the Special Data Dissemination Standard (SDDS) by mid-2001.

Directors commended the authorities on their decision to advance to May 2001 the repurchase of the full amount outstanding under the 1992 Extended Fund Facility (EFF) arrangement.

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

Tunisia: Selected Economic Indicators

	1995	1996	1997	1998	1999	Proj. 2000
			(In percent)			
Real sector						
Real GDP	2.4	7.0	5.4	5.0	6.2	5.0
GDP deflator	5.5	4.5	4.0	3.5	3.5	3.2
Consumer price index (CPI, period average)	6.3	3.8	3.7	3.1	2.7	3.0
	(In millions of U.S. dollars, unless otherwise indicated)					
External sector						
Exports of goods, f.o.b.	5,469	5,519	5,559	5,733	5,864	5,992
Imports of goods, f.o.b.	7,458	7,280	7,514	7,887	8,003	8,278
Current account, excluding capital grants (in percent of GDP)	-4.3	-2.4	-3.1	-3.4	-2.1	-3.2
Foreign direct investment, net	308	262	388	685	357	651
Capital and financial account balance	928	838	710	621	878	568
Total reserves minus gold	1,616	1,916	1,985	1,866	2,289	2,222
External MLT debt (in billions of US$)	9.8	9.9	9.6	10.0	10.3	9.8
Debt service ratio (in percent of exports of goods and nonfactor services)	20.9	21.4	19.4	19.2	18.6	22.4
Real effective exchange rate (in percent) (depreciation -)	2.2	0.7	-0.1	-0.1	1.0	-0.7
	(In percent of GDP, unless otherwise indicated)					
Financial variables						
Fiscal balance 1/	-4.5	-5.1	-4.2	-2.8	-2.6	-2.9
Revenues 2/	29.9	30.3	28.4	29.1	28.9	29.1
Expenditures and net lending	34.5	35.5	32.6	32.0	31.5	32.0
Gross saving	20.2	22.4	23.2	23.5	24.5	24.5
Gross domestic investment	24.7	25.1	26.5	26.9	26.6	27.7
Change in liquidity (M4) (in percent)	10.6	12.4	8.7	9.3	9.4	5.1
Interest rate (money market rate, in percent)	8.8	7.8	6.9	6.9	5.9	5.9

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

1/ Overall deficit excluding grants and privatization.
2/ Excluding grants.