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Tunisia: 2004 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Tunisia

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 2004 Article IV consultation with Tunisia, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **July 1, 2004,** 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 October 6, 2004.** 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 Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its October 27, 2004 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Tunisia.

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

Selected Issues Paper

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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TUNISIA

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for 2004 Consultation with Tunisia

Approved by Amor Tahari and Matthew Fisher

October 6, 2004

- Discussions for the 2004 Article IV consultation were held in Tunis during June 16–July 1, 2004. The staff team consisted of Mr. Fanizza (head), Ms. Koranchelian, and Messrs. Sarr and Söderling (all MCD).

- The mission met with Governor Baccar (Central Bank of Tunisia), Minister Kechiche (Finance), other cabinet members, and government officials. The staff also met with the main trade union, the private business association, and with representatives from the banking sector. Mr. Rouai, Senior Advisor to the Executive Director, attended most of the meetings. A press conference was held at the end of the mission.

- At the conclusion of the last Article IV consultations on July 25, 2003, Executive Directors endorsed the authorities' plans to undertake fiscal consolidation over the medium term to lower government debt, and welcomed the planned move to a floating exchange rate regime and an open capital account. They recommended that the authorities should move vigorously to strengthen the banking sector, so as to allow for the proper functioning of the new monetary policy framework and, in due course, permit capital account liberalization. They welcomed trade liberalization achieved with the European Union (EU). Nevertheless, they expressed concerns about the restrictiveness toward non-EU countries and the high nontariff barriers in general.

- Presidential elections are scheduled for October 2004.

- The authorities intend to publish the 2004 Article IV staff report and selected issues papers.

- Tunisia accepted the obligations under Article VIII, Sections 2(a), 3, and 4, in 1993. Tunisia maintains a multiple currency practice resulting from exchange rate guarantees extended prior to 1988.

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EXECUTIVE SUMMARY

- The policy discussions took place against a backdrop of continued strength in the Tunisian economy. Strong agriculture production and robust nonenergy exports contributed to high growth and a narrowing of the external current account deficit. A rebound in tourism, stronger European demand, and continued real depreciation of the dinar is projected to sustain this strength in 2004.

- Monetary policy remains prudent and inflation under control. Greater exchange rate flexibility and the appreciation of the euro vis-à-vis the US dollar have led to a real depreciation of the dinar, contributing to strengthen Tunisia's external position.

- The central government fiscal deficit was 3.5 percent of GDP in 2003, about 0.8 percentage point higher than the budget deficit target, mainly due to a low tax buoyancy. The 2004 budget deficit target (2.7 percent of GDP) is likely to be met thanks to higher-than-expected nontax revenues.

- Nonperforming loans (NPLs) as a share of bank assets increased by three percentage points to 24 percent in 2003, in part due to difficult economic conditions in certain sectors such as tourism, as well as competitive pressures, which Tunisia is facing in the context of growing openness. Although not a systemic risk in the short term, these weaknesses constitute inefficiencies which hamper growth.

- While Tunisia's economic performance is one of the strongest in the region, catching up with lower-tier OECD income levels remains a key challenge. This will require strengthening the macroeconomic framework and accelerating structural reform.

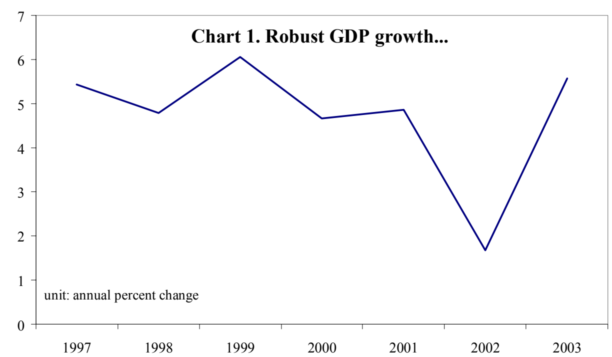
- Tunisia is preparing to gradually open up the external capital account. The authorities and staff agree that this move should be preceded by a gradual transition toward a floating exchange rate supported by a new monetary policy framework, and deeper money and exchange markets.

- Any significant progress toward capital account liberalization necessitates a strengthening of the banking sector. The authorities share this view and are taking corrective measures. Staff stressed that reducing NPLs in a lasting manner will require stricter provisioning rules, the adoption of modern methods of credit appraisal, and the enforcement of sanctions against banks with insufficient provisioning or capital.

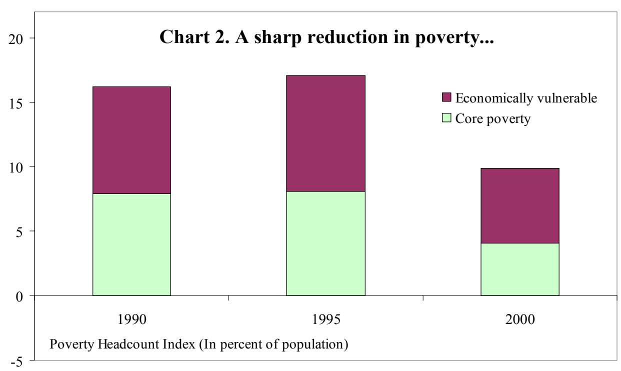
- Reducing the debt-to-GDP ratio will be important for maintaining confidence in the currency as the exchange rate becomes more flexible and monetary policy takes on a more active role. Reducing the weight of the wage bill and improving tax buoyancy will be crucial. Regarding the latter, the authorities are considering requesting technical assistance from the Fund.

- On the structural front, aside from strengthening the banking sector, the discussions focused on trade liberalization and labor market reform.

I. Background and Key Challenges



Source: Tunisian authorities and Fund staff estimates



Source: World Bank.

1. **Over the past decade, Tunisia's economic performance has been one of the strongest in the region, reflecting gradual but continuous structural reforms within a stable macroeconomic context.** Real GDP growth averaging nearly 5 percent combined with social policies have resulted in a sharp reduction in the poverty incidence since the mid-1990s. Meanwhile, in presence of restricted capital flows, fiscal and monetary discipline has contributed to macroeconomic stability, counteracting the potential inflationary risks of real effective exchange rate (REER) targeting.[1] Outward orientation has been a key component of Tunisia's growth strategy, with real annual merchandise export growth averaging 8 percent between 1997 and 2003. As one of the pioneers of the Barcelona process, Tunisia signed an Association Agreement with the EU (AAEU) in 1995.[2] Moreover, the authorities have made progress in privatizing state-owned enterprises, strengthening the banking sector (notwithstanding a recent weakening, see below), and enhancing competitiveness by investing in education, health, and infrastructure. These reforms have contributed to a structural transformation of the Tunisian economy, with the nonprimary sectors (manufacturing, telecom, transportation, and tourism) making up an increasing share of total GDP.

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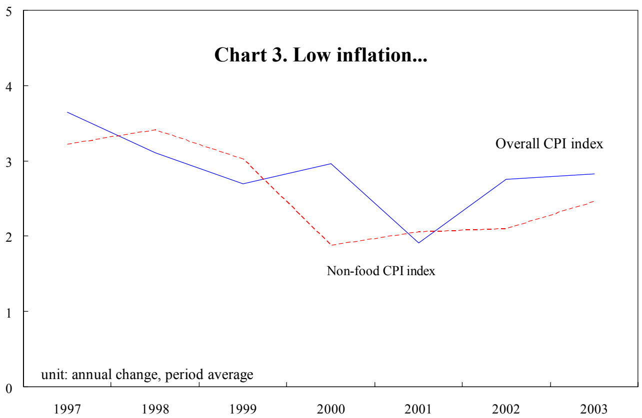
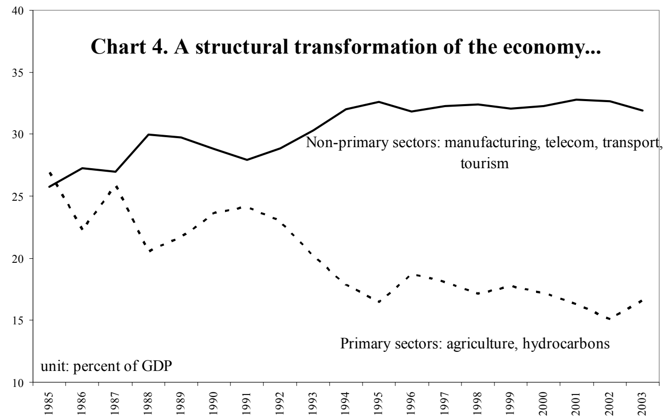
[1] For details on how Tunisia has managed to avoid the potential risks of a REER targeting framework, see the Selected Issues Paper for the 2002 Article IV consultation (IMF Country Report 02/120, 6/17/02) and WP/02/190, 11/01/02.

[2] The Barcelona Process is a major integration initiative between the European Union (EU) and Southern Mediterranean countries.

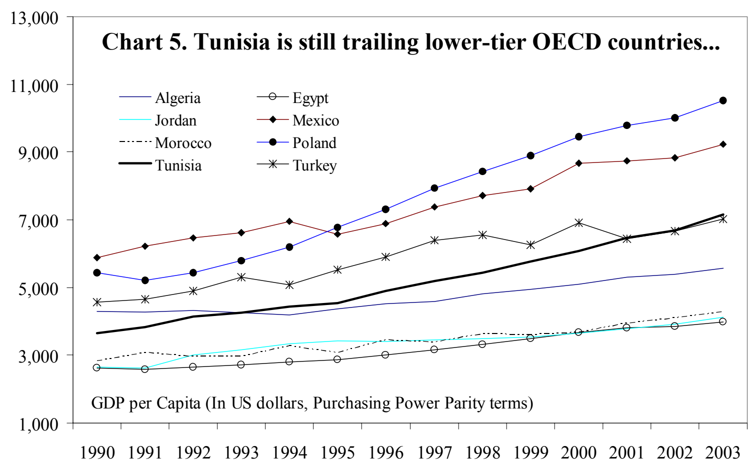


Source: Tunisian authorities.

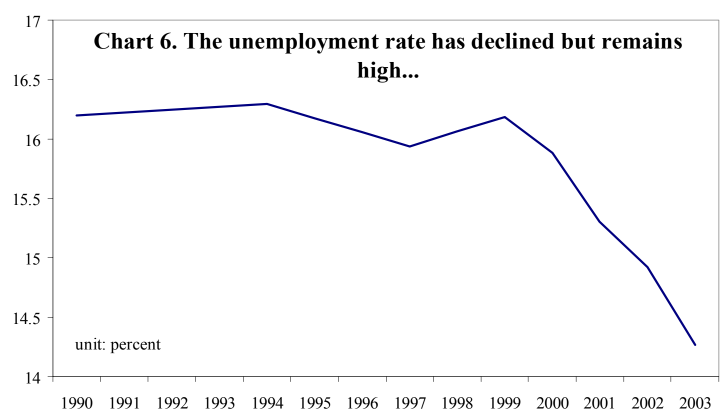


Source: Tunisian authorities and Fund staff estimates.

2. **Nevertheless, Tunisia's objective of approaching lower-tier OECD income levels has not been met and unemployment remains high**. Tunisia's main challenge is to solidify the foundations for strong and sustained growth. Longer-term annual growth rates of more than 6 percent are required in order to have a significant impact on unemployment. In addition, a per-capita GDP growth differential of 2–4 percent would be required to catch up with countries like Poland and Mexico (in purchasing power parity terms) within a decade.



Source: World Economic Outlook.



Source: Tunisian authorities.

3. **Fund surveillance in recent years has focused mainly on the need to accelerate structural reforms and to gradually adapt the macroeconomic framework to Tunisia's increasing integration into the global economy** (Box 1). The authorities recognize that further transformation of the economy is necessary to maintain, let alone improve, the growth performance recorded thus far. The imminent expiration of the Multifiber Agreement (MFA), which will likely slow textile exports, underscores the importance of structural change.[3] In this regard, a renewed impetus to structural reforms could improve productivity and create a business environment in which the private sector can better identify and take advantage of new export opportunities. The authorities also acknowledge the need to reform the macroeconomic framework, to bolster the impact of structural reforms.

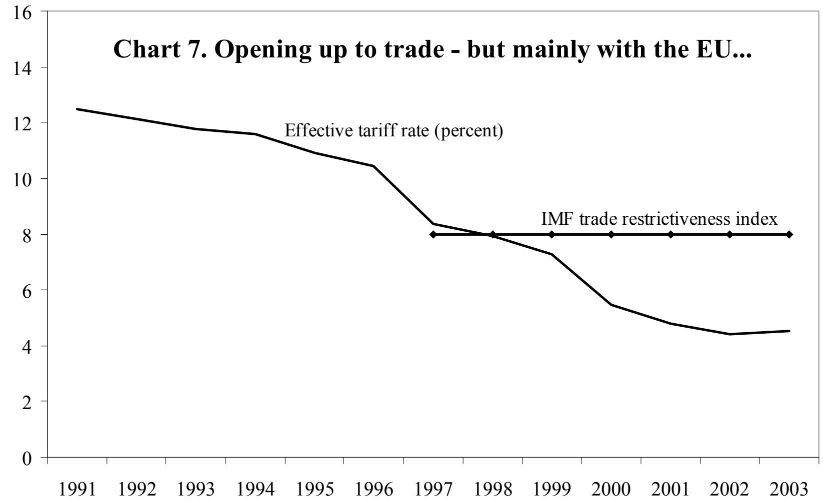
Box 1. Past Fund Surveillance in Tunisia

After exiting Fund-supported programs in the early 1990s, Tunisia has maintained a close and productive dialogue with Fund staff. Over the years, the Fund has played the role of a trusted policy advisor. The authorities have reacted favorably to staff's advice, but have retained full ownership of the economic reform program that has progressed at a gradual, yet steady, pace. Tunisia embraced a policy of transparency at an early stage. In recent years, the policy dialogue has focused on three major areas:

- **The reform of the macroeconomic framework.** The authorities requested Fund advice on how to gradually liberalize the external capital account and staff has proposed a three-phase plan (Box 3). Staff has also worked closely with the authorities in formulating a strategy for exiting the REER targeting exchange rate regime and assisted the authorities in developing a new supporting monetary policy framework.
- **The need to accelerate structural reforms.** While the authorities agreed on this need, they stressed that the pace of reform should take into account Tunisia's particular conditions, especially the need to maintain social cohesion.
- **The policy response to the heightened tensions in the Middle East and the global economic slowdown in 2002–03.** In this context, the authorities took measures to contain emerging fiscal pressures and build up an international reserve buffer.

[3] Textiles account for over 1/3 of total exports.

4. **On the structural front, despite significant progress in liberalizing the economy, there is still scope for improvement.** While Tunisia's tariffs vis-à-vis the EU have been substantially reduced since the mid-1990s, MFN tariffs remain high, at almost three times the average of countries with similar income levels. Nontariff barriers are also important. For these reasons, Tunisia scores 8 out of 10 on the Fund's trade restrictiveness index. The business climate still does not correspond to that of a dynamic emerging economy, and has been one of the main focuses of the World Bank's activities in Tunisia under the Economic Competitiveness Adjustment Loans (ECAL I-III, supported by the EU and the African Development Bank). While the offshore sector enjoys significant economic freedom, onshore activities are still hampered by relatively heavy regulations.[4] Despite measures to liberalize the labor market, inefficiencies remain. Moreover, there are serious weaknesses in the banking sector (Box 2).



Source: Tunisian authorities and Fund staff estimates.

[4] Policy options for phasing out the onshore-offshore dichotomy were discussed in the context of the 2003 Article IV consultations (IMF Country Report 03/259).

Box 2. Tunisia: Banking Sector Reform and Nonperforming Loans

In 1997, the government launched a comprehensive plan to tackle nonperforming loans (NPLs). The plan entailed government assumption of banks' claims on certain public enterprises in return for noninterest bearing 25 year notes. Legislation allowing the transfer of NPLs to Asset Management Companies (AMCs) was also introduced and banking supervision was strengthened. As a result, NPLs fell from 25 percent in 1996 to 19 percent in 2001.

However, NPLs have remained high and have recently increased. The 2002 FSAP found that a weak credit culture and insufficient use of the central bank's powers to impose sanctions explained the high level of NPLs. The weak credit culture was attributed to the significant presence of the government in the banking sector, central bank refinancing policies that privileged priority sectors, and excessive reliance on real estate guarantees in provisioning regulations and credit policies. Adequate provisioning was also discouraged by a lack of full tax deductibility and regulations that did not permit writing off loss category loans backed by real estate collateral. Weak enforcement of sanctions reflected insufficient central bank autonomy, itself related to the presence of the government in the banking sector and in the credit allocation process. Vulnerabilities have recently been exacerbated by shocks to the tourism sector and by ongoing trade liberalization putting competitive pressure on the industrial sector.

The high level of NPLs imposes an efficiency cost to the economy. The 2002 FSAP estimated that the ratio of interest received by banks to performing loans was 100 to 200 basis points higher than it would have been if all loans were performing. Moreover, weak banks' vulnerability to interest rate fluctuations could impede market development and monetary policy reform. These vulnerabilities stem from indexation of high corporate debts to the money market interest rate.

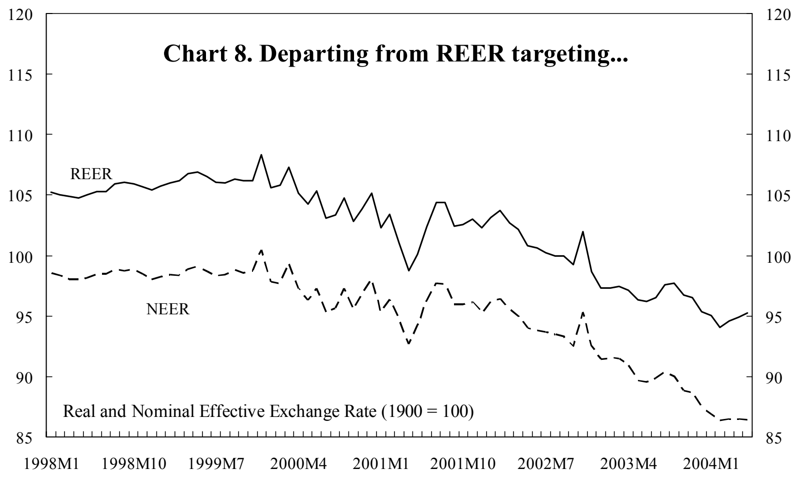
FSAP recommendations to address the nonperforming loans included: (a) reducing the presence of the government in the banking sector; (b) eliminating priority sector considerations in the BCT's refinancing policies; (c) encouraging banks to adopt modern credit appraisal policies; (d) reducing the role of collateral in provisioning policies; (e) facilitating the transfer of NPLs to AMCs; (f) taking advantage of banks' current profitability to request increased provisioning and bank capitalization; (g) promulgating a law on consolidation accounting to enhance banks' appreciation of group and related party risks; and (h) reinforcing the BCT's independence.

Authorities have already taken action in these directions: Priority sectors no longer play a role in monetary policy; a banking law strengthening supervision has been promulgated; banks with insufficient provisions can no longer distribute dividends; a law on consolidation accounting and another defining groups have been promulgated; conditions allowing loan write-offs and judicial procedures for loan recovery have been eased; and a small public bank has been privatized, with another one in progress.

Commercial Banks Financial Soundness Indicators

	1996	1997	1998	1999	2000	2001	2002	2003
Capital adequacy ratio of commercial banks	5.1	6.3	11.7	11.6	13.3	10.6	9.8	9.2
Private banks	9.4	6.8	8.9	10.3	11.5	10.4	10.0	8.3
Public banks	3.4	5.9	14.6	12.8	15.0	11.0	9.4	10.7
Gross nonperforming loans (percent of gross assets)	25.1	23.0	19.5	18.8	21.6	19.2	20.9	24.0
Private banks	17.0	19.4	19.4	18.0	15.3	16.1	18.1	21.6
Public banks	29.3	25.8	19.6	19.5	26.8	22.8	24.3	26.7
Provisions (percent of nonperforming loans)	46.7	50.4	59.7	58.5	49.2	47.4	43.9	43.1
Private banks	61.9	55.3	58.3	58.8	54.7	47.7	44.9	39.9
Public banks	42.1	47.5	60.7	58.3	46.6	47.1	42.9	46.2
Liquidity ratio (Liquid assets/liquid liabilities)	...	...	...	...	...	97.2	103.0	105.0
Net open position in foreign exchange (percent of capital)	...	...	...	1.5	0.1	0.4	0.4	0.7
Management Soundness								
Return on Assets	0.9	0.8	1.2	1.2	1.2	1.1	0.7	0.6
Return on equity	12.3	11.8	12.8	12.8	13.7	14.0	8.0	7.7

Source: Tunisian authorities.



Source: INS

5. **The authorities are preparing to gradually open up the external capital account to tap external savings, allow for portfolio diversification, improve the efficiency of domestic financial markets, and diversify balance of payments financing.** They agreed with Fund staff that such a move would require a gradual transition to a floating exchange rate regime, to retain a degree of monetary independence and avoid giving foreign investors any implicit exchange rate guarantees. The flexibility of the dinar will also be an important factor in preserving competitiveness. A flexible exchange rate will in turn necessitate further fiscal consolidation and a monetary policy ensuring continued price stability. The BCT (in collaboration with Fund staff) has begun preparing the introduction of a money targeting policy framework.[5] The authorities recognize that the high level of nonperforming loans (NPLs) has put Tunisian banks at a competitive disadvantage vis-à-vis foreign banks, calling for caution in liberalizing the capital account. Banking sector weaknesses could also limit the margin of maneuver for monetary policy. Hence, the authorities have placed the objective of strengthening the banking sector at the top of the policy agenda.

[5] See the Supplement to the 2003 Article IV Staff Report (IMF Country Report 03/259, 8/21/03).

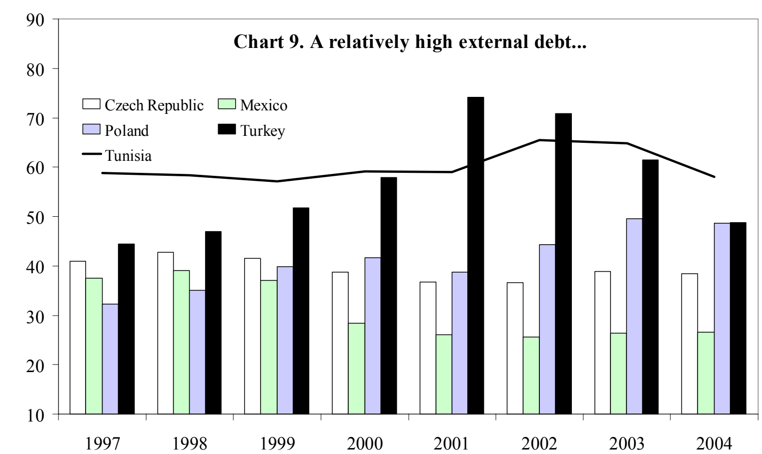
Box 3. Tunisia: External Capital Account Liberalization

Staff has proposed a three-phase plan for liberalizing capital flows:

- *Phase 1* includes steps that could be taken immediately to liberalize medium to long-term flows such as nonresident direct investments and long term loans to listed firms, and limited nonresident investments in local currency government securities.

- *Phase 2* involves liberalizing direct investment by Tunisians abroad, and allowing overseas portfolio investments by institutional investors and portfolio investments by nonresidents in debt instruments. This stage would require that the banking system be on a solid footing to enable it to withstand international competition. Progress would also be needed in the conduct of monetary policy to give a greater role to market forces and in the development of government securities markets to increase market liquidity. Prerequisites are the establishment of a flexible exchange rate regime and a deepening of the foreign exchange market.

- *Phase 3 (full convertibility)* entails liberalizing domestic portfolio investment abroad and loans by residents to nonresidents. Moving to this stage would require a robust financial sector and a resilient balance of payments position.



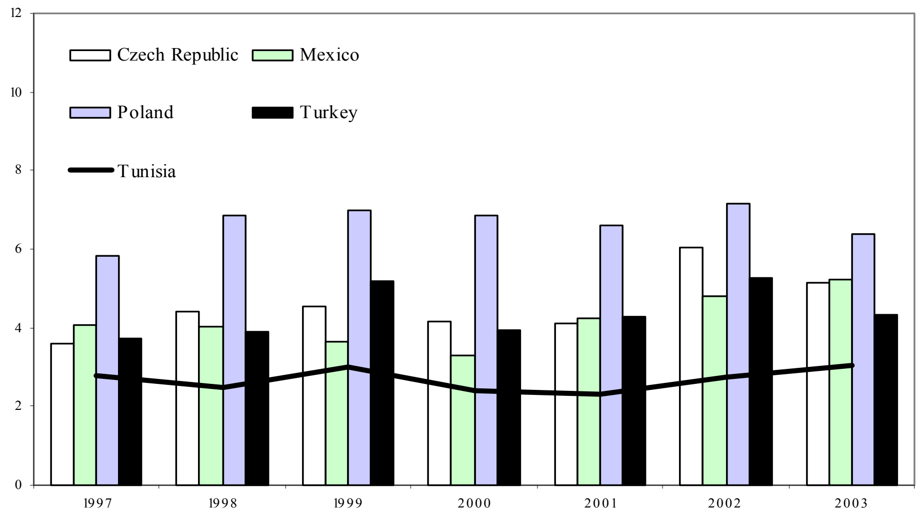
Source: World Economic Outlook. Unit: percent of GDP.

6. **Macroeconomic vulnerabilities in Tunisia are mainly concentrated in the external sector.** Several years of strong growth and prudent fiscal management have placed fiscal policies on a sustainable path, although the public debt-to-GDP ratio remains above that of emerging countries with similar credit ratings. The external position has improved in recent years, although the external debt remains high compared to lower-tier OECD countries and other emerging economies with similar sovereign debt ratings. The external vulnerability exercise points to currency risks, which could potentially constrain the degree of exchange rate flexibility acceptable to the authorities, thereby preventing monetary policy from focusing primarily on price stability.[6] Meanwhile, the level of reserves, at 3 months of

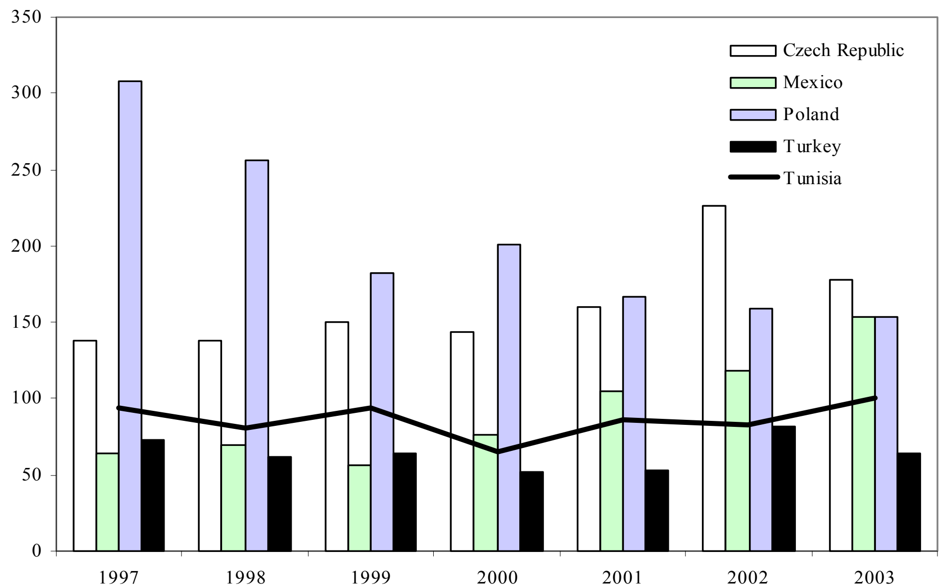
[6] The external vulnerability analysis shows that a 30 percent depreciation could bring the external debt well above 60 percent of GDP over the medium term.

imports and 100 percent of short term debt (although generally below comparator countries), appears to be adequate (Box 4).[7]

Chart 10. Adequate reserves, although generally lower than in comparator countries...



Sources: World Economic Outlook and Tunisian authorities. Unit: months of imports of goods and non-factor services.



Sources: World Economic Outlook and Tunisian authorities. Unit: percent of short-term debt.

[7] Short-term external debt includes current amortization and non-residents' deposits and excludes suppliers credit.

Box 4. Is Tunisia's Net International Reserves Position Adequate?[1]

Foreign exchange reserves in Tunisia have increased over the last decade, from 1.6 months of imports and 63 percent of short-term debt in 1992 to about 3 months of imports and 100 percent of short-term debt in 2003.

The demand for foreign exchange reserves is well explained by fundamentals. Foreign exchange reserves are positively correlated with economic size and current account vulnerability, and negatively correlated with exchange rate flexibility and the opportunity costs of holding reserves.

The estimated long-run relationship between foreign reserves holdings and their determinants yields a demand for reserves that is lower than currently forecasted in Tunisia's macroeconomic framework. Given balance of payments forecasts, the model estimates that 2.5 months of import coverage would be sufficient, compared to 3 months of imports targeted in the medium-term macroeconomic framework.

The gradual move toward a flexible exchange rate should, in time, further reduce the demand for reserves, although a security buffer may be needed in the transition period.

1/ See selected issues paper "Assessing reserves adequacy in Tunisia," forthcoming.

II. Policy Discussions

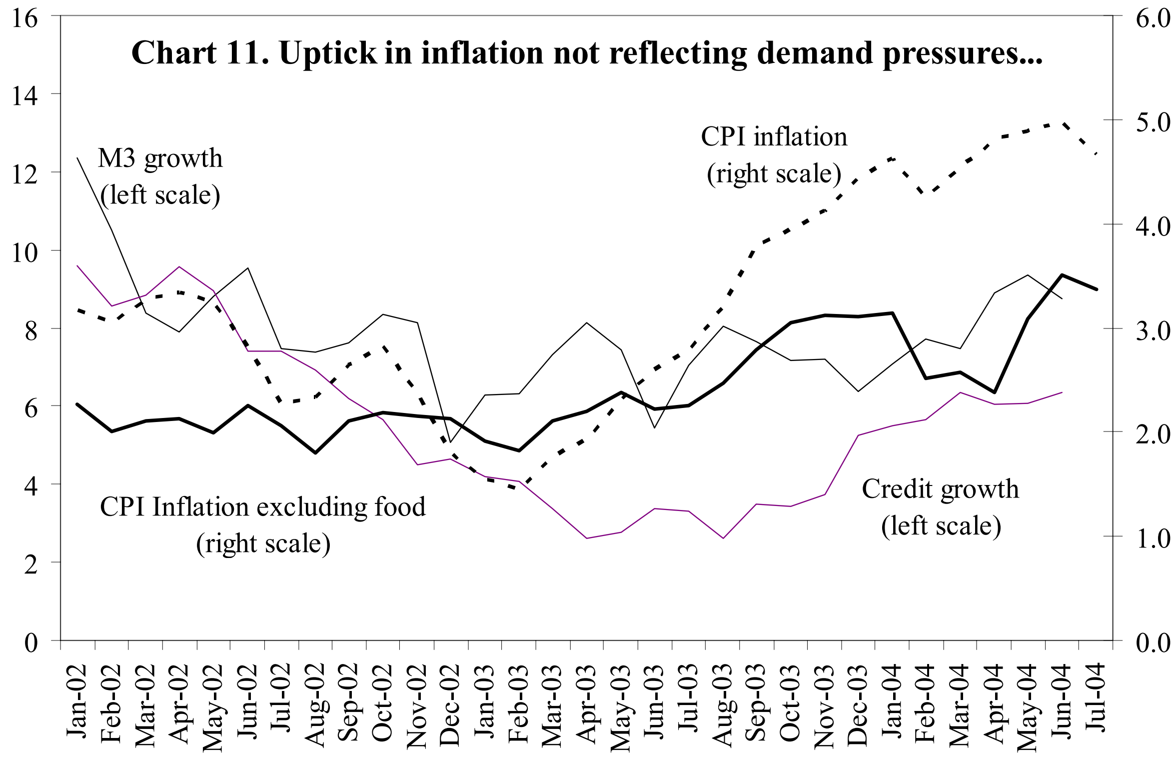
A. Short-Term Outlook

7. **The policy discussions took place against a backdrop of continued strength in the Tunisian economy.** Real GDP growth exceeded 5½ percent in 2003, driven by strong agriculture and robust nonenergy exports. Growth is expected to remain strong in 2004, supported by a rebound in tourism, stronger European demand, and continued real depreciation of the dinar. The external current account deficit is projected at 2½ percent of GDP, ½ percentage point of GDP lower than in 2003, underpinned by strong tourism receipts and continued growth in nonenergy exports. This, in conjunction with significant privatization receipts,[8] will enable Tunisia to reduce its external debt by 7 percentage points of GDP (to 57½ percent) while maintaining a level of reserves equivalent to three months of imports of goods and services.

8. **Monetary policy continues to be prudent.** Money and credit grew more slowly than nominal GDP in 2003. This increase in velocity was attributable to a steepening of the yield curve, which resulted in a fall in money demand in favor of medium- and long-term government securities. The yield curve tilted as the BCT lowered its main short-term policy

[8] The final payment ($227 million) for the second GSM license is due in 2004.

interest rate by an accumulated 87.5 basis points (to 5 percent) during 2003. Moreover, the treasury halted its short term issues to extend the maturity of its debt. Although the rate of inflation began to pick up in 2003, it resulted from adjustments in administered prices and supply factor-driven increases in certain food prices. As evidenced by the relative stability in nonfood prices, neither exchange rate pass-through nor demand pressures appear to have played an important role. Inflation is expected to return to normal levels (below 3 percent) by 2005. In this context, staff did not recommend any change in the BCT's policy stance, absent further price pressures.



Source: Tunisian authorites. Unit: year-on-year percentage change.

9. **Greater exchange rate flexibility has led to a depreciation of the dinar in real effective terms.** This has improved Tunisia's competitiveness and helped strengthen its external position. Staff did not find any evidence of exchange rate misalignment, supported by a continued relative decline in unit labor costs and a broadly unchanged market share in the EU.[9] Looking forward, the authorities agreed on the importance for monetary policy to focus on maintaining price stability to prevent inflation from eroding competitiveness gains achieved so far.

[9] The real effective exchange rate based on unit labor costs depreciated by 4 percent in 2003 (end of period).

10. **Banking sector indicators deteriorated further in 2003.** NPLs as a share of bank assets increased by three percentage points to 24 percent in 2003. Meanwhile, the rate of provisioning decreased slightly to 43 percent of NPLs, although in part due to write-offs and transfers of fully provisioned NPLs to asset management companies (AMCs). Banks' aggregate capital adequacy ratio also decreased, and three banks no longer comply with the minimum requirements. The authorities pointed out that these developments reflect difficult economic conditions in certain sectors such as tourism, as well as competitive pressures, which Tunisia is facing in the context of growing openness. Nevertheless, they agreed with staff on the need to implement the FSAP recommendations and aim at reversing the trend in NPLs in 2005.

11. **On the fiscal front, a low tax buoyancy did not permit further consolidation in 2003, despite the recovery in economic activity.** The central government deficit remained at 3.5 percent of GDP in 2003 (excluding grants and privatization receipts). Tax revenues as a share of GDP decreased by 1 percentage point to 20.5 percent in 2003,[10] because: (a) growth was driven by agriculture and exports, which are little taxed; (b) domestic demand remained sluggish; and (c) ongoing tariff reduction continued to impact customs revenues. For 2004, continued weak tax collection will be offset by a windfall profit transfer from the state-owned telecoms company.[11] On the expenditure side, the authorities have mitigated the impact of higher oil prices on subsidies by adjusting retail prices in early 2004, but a budgetary overrun is still expected in the absence of further adjustments of retail prices. In all, the central government deficit is projected at 2.8 percent of GDP in 2004, close to the budgetary target. Staff stressed the importance of attaining the budgetary target for 2004 and maintaining the deficit below 3 percent of GDP in 2005, or lower in case of continued strong nontax revenues, to maintain the pace of deficit reduction consistent with the medium term consolidation objective (see below). This will require significant efforts in 2005 to compensate for the one-off nontax revenues collected in 2004. This includes efforts to improve tax collection and a reduction in current primary spending of ½ percentage point of GDP.

12. **Against this background, the remainder of the policy discussions focused on:** (a) the strategy to strengthen the banking sector; (b) the strategy for fiscal consolidation; and (c) the medium-term strategy for solidifying conditions for strong and sustainable growth, with the goal of eventually catching up with lower-tier OECD income levels.

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[10] Tax Revenues decreased by half a percentage point of nonagricultural GDP in 2003.

[11] The actual profit transfer turned out more than ½ percentage point of GDP higher than projected in the budget.

B. Strengthening the Banking Sector

13. **While banking sector weaknesses do not pose systemic risks in the near term, staff urged the authorities to step up efforts to address the issue for reasons of efficiency and to support the gradual liberalization of the capital account.** Banks remain profitable in the aggregate. The fiscal cost of maintaining required capital adequacy in public banks would be limited, even in the event of a write-off of most collateralized NPLs.[12] However, current lending practices dampen Tunisia's growth potential and undermine monetary policy reform and any substantial progress toward an open capital account.

14. **The authorities share staff's view regarding the urgency to address these weaknesses and the BCT is accordingly implementing corrective measures.** In 2003 the BCT established a unit charged with monitoring the stability of the financial system. Regulatory changes include a ban on dividend distributions for banks with insufficient provisioning and an accounting law facilitating the monitoring of consolidated risks. Moreover, the authorities intend to make provisions fully tax deductible and further facilitate loan write-offs. Staff welcomed these measures and stressed the need to acknowledge problem loans by provisioning, and if need be increase capital, while relying less on collateral and guarantees. This will encourage banks to fully factor credit risks in their lending policies and should improve allocation of credit toward the most profitable sectors. The authorities indicated that they intended to promote stricter loan collection by encouraging banks to realize collateral and guarantees. They also plan to take measures to facilitate debt rescheduling in the tourism sector. Staff emphasized that to reduce the NPL burden in a lasting manner there is a need for adopting modern credit appraisal methods, enhancing the autonomy of the BCT to ensure stricter enforcement of sanctions against banks with insufficient provisions or capital, and diminishing the government's presence in the financial sector.

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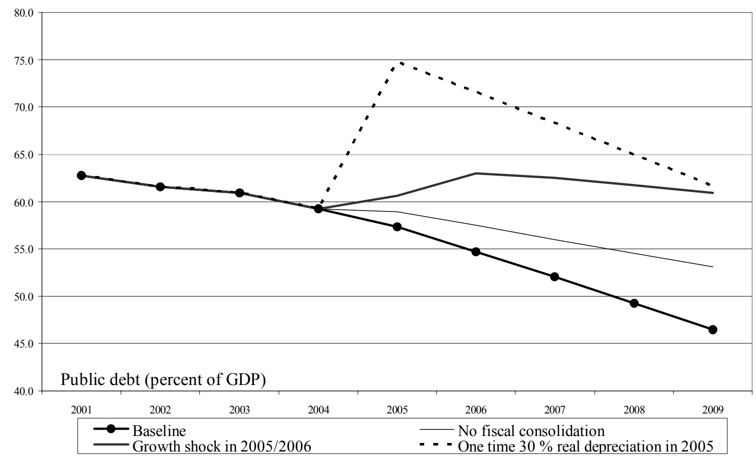
[12] The 2002 FSAP estimated this cost at around 1 percent of GDP.

C. Strategy for Fiscal Consolidation

Chart 12. Limited fiscal vulnerabilities...



15. **Although fiscal sustainability does not emerge as a major concern, staff has advocated reducing public debt to cement confidence and increase flexibility in fiscal policy.** At over 60 percent of GDP, public debt remains above the median (50 percent) of vulnerable emerging market countries. Reducing the debt-to-GDP ratio will be important in maintaining confidence in the currency as the exchange rate becomes more flexible and monetary policy takes on a more active role. Staff has advised the authorities to take advantage of Tunisia's favorable growth prospects, combined with low and fixed interest rates on a significant portion of its external debt, to reduce the public debt-to-GDP ratio to below 50 percent. Accordingly, the fiscal deficit should be kept below 3 percent of GDP in the near term and be gradually reduced to 1½ –2 percent over the medium term. The authorities share this view but are challenged by a weak tax buoyancy and a high wage bill.

16. **The authorities have taken steps to improve tax collection and agree with staff that more far-reaching tax reforms may be needed.** Going forward, pressures on revenues will be accentuated by the inevitable reduction of customs revenues as a result of tariff reform,[13] the economy's increasing export orientation, and an expected drop in profit transfers from state-owned enterprises in the medium term, as these are privatized. Consequently, the authorities are taking measures to improve tax collection. Notable is the extension in 2003 of the VAT to telecommunications services. Staff also advised the authorities to phase out tax exemptions and broaden the tax base for direct taxation.[14] The authorities are considering requesting technical assistance from the Fund in these areas.

[13] The bulk of the impact of tariff reduction has already taken place, with trade taxes declining from around 5 percent of GDP in the early 1990s to 1.7 percent in 2003. Nevertheless, this ratio is projected to decline by at least another ½ percentage point of GDP over the medium term.

[14] Most tax exemptions are in favor of the off-shore sector. For a discussion, see IMF Country Report 03/259, 8/21/03.

17. **On the expenditure side, the wage bill, at 12 percent of GDP, continues to weigh on government finances and represents a rigidity for fiscal policy.** Consequently, staff has advised the authorities to consider a civil service reform covering both the remuneration system and the size of public employment. The authorities, however, saw little scope for any significant reduction in the wage bill in the medium term, underscoring that education and health personnel account for a large share of wage outlays. They emphasized the key role of education for the success of Tunisia's development strategy. Regarding other expenditures, subsidies on petroleum products and food staples represent an annual cost to the government of approximately ½–1 percent of GDP. Moreover, swings in world commodity prices leave the government with little control over these costs, as seen by the impact of the recent increase in oil prices. The authorities agreed that the pursuit of full price liberalization, in conjunction with well targeted transfers, could produce substantial savings. A major reform that could in time improve the efficiency of public expenditure is the planned introduction of a performance-based budget system.

D. Medium-Term Strategy to Accelerate and Sustain Growth

18. **Tunisia has the potential to improve its already strong economic record and in time place itself at par with lower tier OECD income levels.** This will require both changes in the overall macroeconomic policy framework and policies that favor private sector investment and overall productivity growth in the economy. Further liberalization and improvement of the business climate will hence be key. Export orientation will continue to be the cornerstone of Tunisia's development strategy, ensuring both high growth and external sustainability. In this regard, the imminent expiration of the MFA constitutes an additional challenge. Against this background, the ongoing integration with the EU in the context of the New Neighborhood Policy initiative presents a timely opportunity to accelerate structural reforms. To fully benefit from this initiative, Tunisia faces the challenge of harmonizing political, economic, legal, and institutional frameworks with European standards. Staff recommended stepping up efforts to conclude an ambitious program with the World Bank in the context of ECAL IV.

Box 5. Tunisia: 2005–09 Macroeconomic Framework

The medium-term macroeconomic framework projects an average annual real GDP growth of 6 percent over 2005–09, consistent with a continued significant decline in unemployment. This growth objective would require an increase in gross investment of about 0.5 percentage points of GDP over the medium term and an average annual total factor productivity growth of 0.8 percent. This performance will be feasible only if supported by a strengthening of the macroeconomic framework and an acceleration of structural reforms.

The external current account deficit is projected to narrow from 3 percent of GDP in 2005 to 2.7 percent in 2009. This improvement would mainly result from higher nonenergy merchandise exports and tourism. After an initial soft patch in export growth due to the expiration of the MFA in January 2005, average annual export growth is projected at around 6 ½ percent during 2006–09 on account of diversification and improved competitiveness.

New external borrowing is expected to remain fairly constant over the medium term, allowing a gradual decline in the level of external debt from 58½ percent at end-2004 to 47 percent of GDP at end-2009. Reserves are projected to remain around 3 months of imports

The central government deficit is projected to fall from 2.8 percent of GDP in 2004 to 1.7 percent in 2009 (excluding grants and privatization receipts). As a result, the consolidated government debt would fall from 59 of GDP at end-2004 to 46 ½ percent at end-2009.

Reform of the macroeconomic policy framework

19. **To complete the opening of the Tunisian economy, the authorities are preparing a gradual liberalization of the external capital account in close cooperation with Fund staff.** In addition to strengthening fiscal policies, this liberalization will necessitate parallel changes in the conduct of monetary and exchange rate policies.

Development of financial markets and the monetary policy framework

20. **Preparations to make monetary policy more dynamic in the context of broad money targeting are at an advanced stage.** The BCT has set up a forecasting framework for base money (the operating target) and broad money, which is being tested in parallel with the existing framework. Moreover, the BCT recently introduced quantitative tenders of base money at multiple interest rates, consistent with the base money targeting strategy. The authorities and staff agree that the BCT could adopt an explicit inflation targeting framework once financial markets have deepened, an inflation forecasting framework has been developed, and currency risks have abated.

21. **The mission reiterated that base money targeting should be accompanied by a larger role for the money market in the recycling of liquidity.** A deep and well-functioning money market is necessary for interest rates to be responsive to liquidity conditions, in turn a prerequisite for a strong monetary policy transmission mechanism. In

this vein, a new law on repurchase agreements was passed in 2003 and is awaiting implementation. A deepening of the market will also depend on the availability of government securities, which are the preferred assets for securing money market transactions. Accordingly, it is important to maintain a presence on the securities market at all maturities and the recent decision to shift the maturity structure of treasury bills away from the shortest maturities may thus need to be reconsidered.

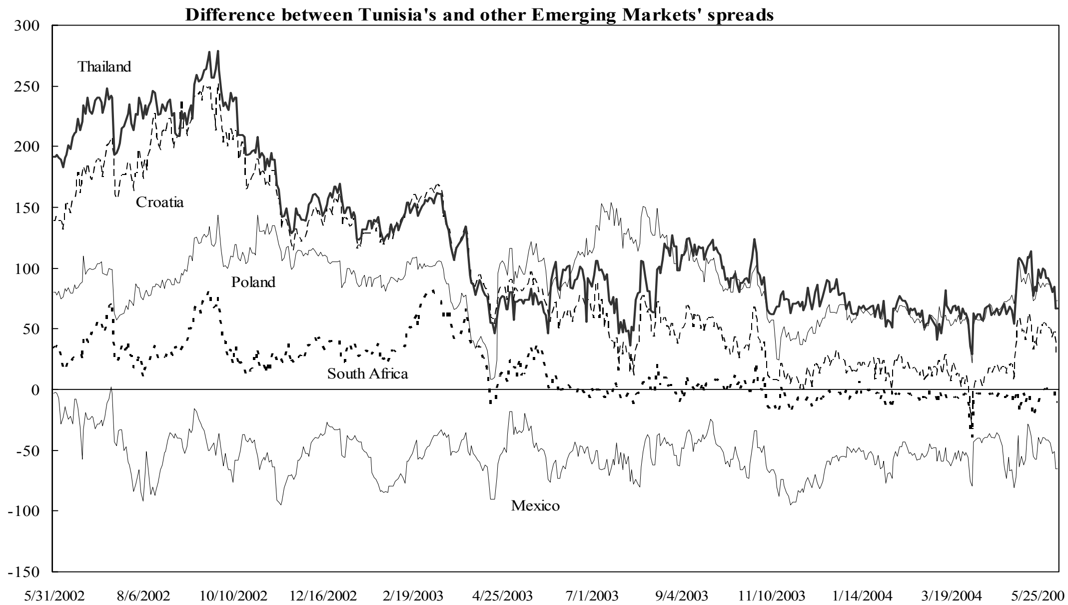
Exchange rate policy and the opening of the capital account

22. **Given the limited access of the private sector to international capital markets, much of the balance of payments has been financed by government borrowing.** Tunisia's investment grade sovereign debt rating has greatly facilitated the government's access to international capital markets (Box 6). However, a significant foreign currency-denominated public debt has emerged. Allowing the private sector to tap foreign capital will have the advantage of diversifying balance of payment financing and providing additional sources of foreign exchange.

Box 6. Recent Developments in Tunisian Sovereign Debt

The premium on Tunisian sovereign debt compared to other emerging economies with similar ratings (BBB-/BBB/BBB+) has narrowed significantly over recent years. Tunisia's spreads are now broadly at par with South Africa's and Croatia's, and has long been lower than Mexico's.

Tunisia's latest Eurobond issue in March 2004 captured EUR 450 million, at a spread of 119 basis points. The issuance was initially announced for EUR 300 million, but was increased as the bond was oversubscribed by nearly 3 to 1. The maturity was 7 years.



Source: JP Morgan (EMBI).

23. **In addition, to the extent that nonresidents are willing to hold dinar denominated debt, Tunisia's exposure to currency risk can be diminished.** In this vein, the authorities began opening the local securities market to limited foreign participation in 2004, in line with IMF and World Bank recommendations. Staff noted the importance of further improving public debt management to promote market liquidity, necessary for the success of this measure.

24. **The authorities and staff share the view that full dinar convertibility should be preceded by a gradual introduction of a flexible exchange rate regime.** Accordingly, in recent years, they have increasingly deviated from the earlier policy of maintaining the REER constant. Staff has underlined the importance of a deep and efficient foreign exchange market, to allow for fully market-determined exchange rates. It welcomed a recent reduction

in surrender requirements and advocated their elimination.[15] Staff further encouraged the BCT to promptly discontinue the obligation for banks to transfer their end-of-day foreign exchange balances to the central bank (*nivellement*). The authorities indicated that they were preparing the relevant legislation to abolish this requirement. Staff also reiterated that the BCT should end posting bid/ask spreads for foreign exchange, to expand the role of market forces in the determination of the exchange rate. Such a measure would not prevent the BCT from intervening in the market to implement its exchange rate policy.

Structural Reforms

25. **While the World Bank is taking the lead in supporting the authorities' structural reforms, staff urged the authorities to minimize structural impediments to sustained strong growth.** In addition to financial sector reform, discussions focused on trade and labor market liberalization.

Trade liberalization

26. **Tunisia's traditional focus on trade integration with the EU has been appropriate, given the geographical proximity and historical ties.** Nevertheless, a large untapped potential for trade exists with non-EU countries (Box 7). In light of this, and considering the still high level of MFN tariffs, staff recommended that Tunisia further liberalize trade on a multilateral basis, in parallel with the integration efforts with the EU.[16] Staff also emphasized the need to liberalize services, including communication, distribution, and transportation services. The authorities pointed out that multilateral trade liberalization is underway, with the lowering and simplification of MFN tariffs in the 2004 budget law being just a step in an ongoing process. In this regard, they indicated that the 2005 budget law would provide further MFN tariff cuts. Moreover, they reiterated that the Fund trade restrictiveness index overstates the closedness of Tunisia's trade regime, since it does not adequately reflect the liberalization that has taken place with the EU.

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[15] Surrender requirements were reduced from 50 percent to 30 percent of export receipts.

[16] Average MFN tariffs are 32.7 percent for all products, 22.5 percent for industrial products, and 68 percent for agricultural products.

Box 7. Is Tunisia Trading to Its Potential?[1]

The analysis uses a gravity model of bilateral trade taking into account trading partners' size, geographical location, economic structure, and linguistic and colonial ties. The model yields the following main results:

Tunisia's aggregate trade with the EU widely surpasses model predictions, but an important trade potential remains nonetheless. A closer look at EU-Tunisian trade reveals that the large wedge between predicted and actual trade levels is explained by significant over-trading with a few countries, especially France and Italy. Meanwhile, Tunisia still under-trades with half of the EU countries, most notably the UK.

By far the largest untapped trade potential lies outside the EU, especially in the US and Japan. This underscores the need for Tunisia to accelerate trade liberalization on a multilateral basis, in parallel with the more advanced integration process with the EU. Within the region, Algeria presents a considerable potential to increase trade. Stepped up efforts to enhance regional integration may therefore have a measurable impact on Tunisia's total trade.

The wide disparity in Tunisia's trade performance with EU countries suggest that the AAEU have not introduced serious distortions in the trade regime. Estimated substantial over-trading with a large number of non-EU countries reinforces this notion, although a richer analysis including changes in the trade performance over time would be useful before drawing firm conclusions.

1/ See selected issues paper "Is Tunisia Trading to its Potential?," forthcoming.

27. **Staff also noted the importance of reducing nontariff barriers.** In this regard, the authorities have streamlined customs procedures through the integrated customs network "Tunisia Trade Net," the recent introduction of selective customs inspection procedures, and simplified technical controls. Nevertheless, although customs clearance delays have been substantially reduced, further progress is needed, in particular to allow Tunisia to maximize the benefits from its geographic proximity to Europe. The authorities indicated that they had begun studying options for a potential dismantling of state import monopolies.[17]

Increased labor market flexibility

28. **The mission discussed with the authorities the need for labor market flexibility to facilitate the reallocation of labor in response to structural changes in the economy.** With employment creation high on the authorities' agenda, they have introduced temporary work contracts, which have already helped reduce the unemployment rate by one percentage point in the past two years, to 14.3 percent. Other important measures include active labor market policies to match labor supply and demand and programs to retrain labor in line with changing employment needs.

[17] Government monopolies include imports of petroleum products, cereals, pharmaceuticals, coffee, and sugar.

Box 8. Would the Removal of Firing Restrictions Reduce Unemployment in Tunisia?[1]

The government is well aware that promoting employment and facilitating the reallocation of labor in response to structural changes in the economy require flexible labor markets.

Tunisia's protective and complex labor regulations hamper the flexibility of the labor market. Job termination regulations are still rigid and protective: dismissals for economic reasons are heavily regulated, and there is strong government interference.

Growth has only partially contributed to employment generation. While average economic growth was about 5 percent per year over the last decade, the unemployment rate decreased by only 2 percentage points over the period.

Simulation results show that a removal of firing restrictions would contribute to increasing employment, although it will not solve Tunisia's unemployment problem. Results from a matching model with firing restrictions show that removing restrictions on dismissals would reduce unemployment by 1 percentage point. Although positive, this impact is not sufficient to bring unemployment to acceptable levels.

[1] See the selected issues paper "Employment Protection and Unemployment: Tunisia's Experience," forthcoming.

29. **Staff noted, however, that the complex regulations and procedures covering dismissals could limit the creation of permanent employment.** Simulations show that removing restrictions on dismissals would have a beneficial impact on job creation, although it would not solve Tunisia's unemployment problem (Box 8). In this regard, maintaining strong and sustainable growth remains the key to reducing unemployment in Tunisia.

E. Other Issues

30. **A law against money laundering and the financing of terrorism has been adopted.** The enactment of this law represents a substantial improvement of the country's regime to combat money laundering and the financing of terrorism. The central bank is preparing its implementing regulations.

31. **Staff encouraged the authorities to maintain efforts toward increased regional integration.** The authorities agree that large untapped markets remain in the Maghreb region that could constitute an additional source of growth.

32. **Tunisia continues to improve the quality and dissemination of economic and financial statistics within the framework of the Special Data Dissemination Standard (SDDS),** to which it has adhered since 2001.

III. Staff Appraisal

33. **The Tunisian economy continues to do well, ranking among the leaders in the region in terms of growth and market-oriented reforms.** After showing resilience to shocks during 2001–02, the economy is recovering while the external position is strengthening. This performance is a result of strong forward-looking macroeconomic and structural policies. The main challenge is now to enhance this performance to reach lower-tier OECD income levels and further reduce unemployment.

34. **The short-term outlook is favorable, with Tunisia well positioned to benefit from the expected pick up in European demand.** The rebound in tourism, the favorable export performance, and the continued strength in agriculture augur well for a broad-based recovery.

35. **In this context, the monetary policy stance remains appropriately prudent.** The recent pick up in inflation does not appear to result from either demand pressures or exchange rate pass-through and thus does not call for a monetary tightening. On the other hand, with the recovery gaining momentum, the scope for further declines in the BCT's policy rates seems to have been exhausted.

36. **The gradual increase in exchange rate flexibility has translated into improved external competitiveness and a strengthened external position.** Continuing this approach will help contain the impact of recovering domestic demand on the external current account and is consistent with the authorities' objective of eventually adopting a floating exchange rate regime.

37. **Over the years, fiscal policy has aimed toward gradual fiscal consolidation and has ensured fiscal sustainability.** The consolidation efforts were maintained even in 2002, in the context of sluggish growth. These efforts aim at reducing the government debt-to-GDP ratio, which remains above that of emerging countries with similar credit ratings. However, weakening tax revenues prevented a deficit reduction in 2003. Moreover, a narrowing of the deficit will likely occur in 2004 only thanks to significantly higher-than-budgeted nontax revenues. To enhance the credibility of the authorities' medium-term public debt reduction objective, it will be important to take measures to maintain the 2005 fiscal deficit at the 2004 level, despite the projected fall in nontax revenues. The steps that the authorities have taken to counter the downward trend in tax revenues are encouraging. Nevertheless, staff recommends a broad review of the tax-system aiming at improving its buoyancy. Accordingly, the authorities' interest in Fund technical assistance in this area is welcome.

38. **As regards expenditures, the authorities' strategy of gradually reducing the budgetary cost of food and oil-price subsidies should be complemented by efforts to reduce the burden of the wage bill.** The authorities should consider the benefits of a broad-based civil service reform, which could not only produce expenditure savings but also improve service delivery.

39. **The conditions of the banking sector are cause of concern.** Although unlikely to be a source of macroeconomic instability in the near term, banking sector weaknesses raise the cost of capital and hinder the authorities' plans to liberalize the external capital account and reform the monetary policy framework. If not addressed, these weaknesses constitute a major vulnerability that could hamper Tunisia's medium-term growth prospects. It is reassuring that in addition to implementing several FSAP recommendations, the authorities have stepped up efforts to encourage the realization of collateral and thus enforce better collection of NPLs. However, reducing NPLs in a lasting manner will require stricter provisioning rules, the adoption of modern methods of credit appraisal, and the enforcement of sanctions against banks with insufficient provisions or capital. Disengaging further the government from the financial sector would certainly facilitate this task.

40. **Over the medium-term, reinvigorating structural reforms is essential to bring Tunisia close to lower-tier OECD income levels.** The imminent expiration of the MFA renders the need for higher productivity growth and private investment all the more compelling. The authorities' structural reform strategy is shaped in the context of the EU's New Neighborhood Policy initiative and the preparation of the World Bank's ECAL IV that place appropriate emphasis on improving the private investment climate.

41. **Trade integration with the EU has served Tunisia well, substantially opening the economy to foreign trade and investment.** However, further progress in multilateral trade liberalization could provide significant additional benefits. Staff encourages the authorities to further lower MFN tariffs within the 2005 budget law. Liberalizing services, in particular distribution and transportation, could also help boost the country growth potential.

42. **Reducing Tunisia's high unemployment rate requires not only growth-oriented policies but also increased labor market flexibility.** The recent increased flexibility in hiring—with the introduction of temporary work contracts—appears to have contributed to the decline in the unemployment rate. The authorities should consider reducing the constraints on dismissals, which could help facilitate labor market adjustment to structural changes in the economy.

43. **The authorities are making progress in strengthening their monetary and exchange rate policy framework.** These changes are needed not only to support efforts to liberalize the external capital account, but also to bolster the impact of structural reforms. The BCT is now ready to adopt a money targeting framework. Implementing this framework will, however, require continued efforts to deepen the money market.

44. **The authorities' exchange rate policy has already departed from the REER rule and aims at gradually introducing a floating exchange rate—a condition for preserving a degree of monetary policy independence under an open capital account.** Further reducing the BCT's role in determining the exchange rate calls for a deepening of the exchange market. The limited opening of the government securities markets to foreign investors, the reduction of the surrender requirement, and the elimination of the "*nivellement*"

will help create more scope for market forces to determine the exchange rate. In this context, the BCT should also refrain from posting bid/ask spreads for the exchange rate.

45. **Staff supports the authorities' gradual approach to capital account liberalization**. Removing capital controls could benefit investment, help develop the domestic financial markets and facilitate the financing of the balance of payments. However, further progress toward capital account liberalization requires addressing the persisting weaknesses in the banking sector.

46. **Staff commends the authorities for their continued commitment to transparency of economic policies.** Tunisia has published the concluding statements of Fund missions and routinely publishes staff reports of Article IV consultations.

47. It is proposed that the next Article IV consultations take place within the standard 12-month cycle.

Table 1. Tunisia: Selected Economic and Financial Indicators, 2000–04

	2000	2001	2002	Est. 2003	Proj. 2004
Production and income (percent change)					
Nominal GDP	8.2	7.7	4.0	7.9	9.3
Real GDP	4.7	4.9	1.7	5.6	5.6
GDP deflator	3.3	2.7	2.3	2.2	3.5
Consumer price index (CPI), average	3.0	1.9	2.8	2.8	3.4
Gross national savings (in percent of GDP)	23.1	23.5	21.6	22.2	22.0
Gross investment (in percent of GDP)	27.3	27.8	25.2	25.1	24.5
External sector (percent change)					
Exports of goods, f.o.b. (in $)	-0.4	13.2	3.8	17.1	11.0
Imports of goods, f.o.b. (in $)	1.0	11.2	-0.2	14.7	9.8
Exports of goods, f.o.b. (volume)	7.3	15.7	1.9	7.2	0.9
Import of goods, f.o.b. (volume)	6.5	13.6	-2.4	3.4	0.6
Trade balance (in percent of GDP)	-11.6	-12.0	-10.1	-9.1	-8.5
Current account, excl. grants (in percent of GDP)	-4.2	-4.3	-3.5	-2.9	-2.5
Terms of trade (deterioration -)	-2.1	-0.2	-0.4	-1.5	...
Real effective exchange rate (depreciation -) 1/	-1.7	-2.4	-1.1	-4.1	...
Central government (percent of GDP) 2/					
Total revenue, excluding grants and privatization	24.0	24.0	24.4	23.7	23.4
Total expenditure and net lending	27.9	27.8	27.9	27.1	26.2
Central government balance, excl. grants and privatization	-3.9	-3.8	-3.5	-3.5	-2.8
Central government balance, incl. grants, excl. privatization	-3.7	-3.5	-3.1	-3.2	-2.6
Total government debt (foreign and domestic)	60.8	62.8	61.6	60.9	59.2
Money and credit (percent change)					
Credit to the economy	24.2	11.5	6.5	6.2	7.7
Broad money (M3) 3/	14.7	10.3	4.5	6.8	9.3
Velocity of circulation (GDP/M3)	1.882	1.839	1.830	1.849	1.849
Interest rate (money market rate, in percent, e.o.p)	5.88	5.94	5.91	5.00	...
Official reserves					
Gross official reserves (US$ billions, e.o.p)	1.8	2.0	2.3	3.0	3.2
In months of imports of goods & services, c.i.f.	2.4	2.3	2.7	3.0	2.9
Total external debt					
External debt (US$ billions) 4/	11.4	11.6	13.7	16.1	16.2
External debt (in percent of GDP) 4/	58.4	58.1	65.2	64.4	57.4
Debt service ratio (percent of exports of GNFS)	22.6	15.6	17.2	15.1	19.0
Financial market indicators					
Stock market index 5/	1443	1267	1119	1250	1332
Memorandum items:					
GDP at current prices (TD millions)	26,685	28,741	29,890	32,261	35,255
GDP at current prices (US$ billions)	19.5	20.0	21.3	25.0	28.2
GDP per capita (US$)	2,036	2,068	2,181	2,535	2,822
Population (millions)	9.6	9.7	9.8	9.9	10.0
Exchange rate: dinar/US$ (average)	1.37	1.44	1.42	1.29	...

Sources: Tunisian authorities and staff estimates and projections

1/ Information Notice System.
2/ Excludes the social security accounts.
3/ Deposit money banks
4/ Short-term external debt includes nonresidents deposits and excludes commercial debt.
5/ TUNINDEX. (1000 = 4/1/1998). 2004 is for September 10, 2004.

Table 2. Tunisia: Balance of Payments, 2000–04

(In millions of U.S. dollars)

	2000	2001	2002	Est. 2003	Proj. 2004
Current account	-821	-863	-746	-730	-701
Trade balance	-2,251	-2,391	-2,124	-2,270	-2401
Exports	5,836	6,606	6,857	8,027	8,909
Energy	705	610	641	801	798
Non-energy	5,131	5,996	6,215	7,226	8,110
Imports	-8,087	-8,997	-8,980	-10,297	-11,310
Energy	-874	-885	-863	-1,130	-1,150
Non-energy	-7,214	-8,112	-8,117	-9166	-10160
Services and Transfers (net)	1,430	1,528	1,378	1539	1700
Nonfactor	1,615	1,550	1,301	1,362	1,617
o/w Tourism	1,527	1,627	1,422	1,477	1,743
Factor Services and Transfers (net)	-185	-22	77	177	83
o/w Workers' remittances	795	927	1,070	1,250	1,359
o/w Interest payments on external debt	-515	-485	-516	-572	-681
Capital and financial account	578	1,123	885	1,113	919
Excluding grants	569	1067	802	1047	815
Capital account	3	53	76	59	96
Financial account	575	1,070	810	1,054	823
Direct foreign investment (net)	730	443	801	553	821
Medium and long term loans (net)	223	883	766	806	178
Disbursement	1,596	1,842	1,874	1,874	1,802
Amortization	-1,373	-959	-1,108	-1,068	-1,624
Short term capital	-348	-231	-723	-271	-176
Errors and omissions (including financing gap)	-30	-24	-34	-34	0
Overall balance	-242	260	140	383	218
Changes in gross reserves 1/	465	-154	-349	-653	-193
Use of IMF resources	40	31	0	0	0
Other assets, net (increase -)	425	-185	-349	-653	-193
Memorandum items:					
Current account balance/GDP (in percent)	-4.2	-4.3	-3.5	-2.9	-2.5
Reserves (in billions of $)	1.8	2.0	2.3	3.0	3.2
Reserves in months of imports of goods & services	2.4	2.3	2.7	3.0	2.9
External medium- and long-term debt (in billions of $)	9.9	10.2	12.1	14.3	14.4
External medium- and long-term debt/GDP (in percent)	51.0	51.2	57.5	57.0	51.0
External short-term debt (in billions of $) 2/	1.5	1.4	1.6	1.8	1.8
External short-term debt/GDP (in percent) 2/	7.5	6.9	7.8	7.4	6.4
Debt service ratio (as percentage XGS)	22.6	15.6	17.2	15.1	19.0
Real goods export growth (in percent)	7.3	15.7	1.9	7.2	0.9
Nonenergy	6.3	19.0	-0.8	5.4	3.3
Real goods import growth (in percent)	6.5	13.6	-2.4	3.4	0.6
Nonenergy	7.4	13.6	-4.2	0.6	1.5

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

1/ Differs from the overall balance because of valuation effects.
2/ Short-term external debt includes non-residents deposits and excludes commercial debt.

Table 3. Tunisia: Central Government Financial Operations, 2001–09 1/

			Est.	Projections					
	2001	2002	2003	2004	2005	2006	2007	2008	2009
	(In millions of dinars)								
Total revenue and grants and privatization	6,994	7,748	7,716	8,670	8,853	9,618	10,473	11,436	12,466
Total revenue	6,904	7,290	7,632	8,261	8,644	9,418	10,273	11,236	12,266
Tax revenue	6,222	6,429	6,654	7,177	7,754	8,489	9,304	10,227	11,218
o/w income taxes	1,828	2,025	2,177	2,364	2,540	2,791	3,067	3,377	3,716
VAT	1,930	1,895	2,006	2,233	2,442	2,720	3,032	3,389	3,774
trade taxes	655	595	554	547	577	585	593	603	606
Nontax revenue	683	854	960	1,075	890	929	968	1,009	1,048
Capital income	0	7	19	9	0	0	0	0	0
Total expenditure and net lending	7,988	8,326	8,752	9,246	9,691	10,451	11,286	12,199	13,169
Total expenditure	7,886	8,230	8,622	9,221	9,691	10,451	11,286	12,199	13,169
Current expenditure	5,659	5,997	6,317	6,873	7,123	7,609	8,140	8,712	9,305
Wages and salaries	3,392	3,645	3,937	4,239	4,544	4,871	5,222	5,598	6,001
Goods and services	623	627	658	638	687	749	818	893	976
Interest payments	885	915	904	1,000	1,004	1,063	1,135	1,215	1,284
domestic	396	380	359	400	409	450	511	564	606
external	489	535	546	600	595	613	624	651	678
Transfers and subsidies	758	809	819	894	887	926	965	1,006	1,045
Other expenditure (nonallocated)	0	0	0	102	0	0	0	0	0
Capital expenditure	2,228	2,233	2,305	2,348	2,568	2,842	3,146	3,487	3,864
Direct investment	1,337	1,322	1,335	1,397	1,543	1,724	1,926	2,154	2,408
Capital transfers and equity	891	912	970	951	1,025	1,118	1,220	1,333	1,456
Net lending	102	96	130	25	0	0	0	0	0
Central Govt deficit (-) (excl grants and priv.)	-1,084	-1,035	-1,120	-985	-1,047	-1,033	-1,013	-963	-903
Grants	79	118	77	75	109	100	100	100	100
Privatization Proceeds	11	339	8	334	100	100	100	100	100
Central Govt deficit (-) (incl grants and priv.)	-994	-578	-1,035	-576	-838	-833	-813	-763	-703
Financing	994	578	1,035	576	838	833	813	763	703
Foreign	1,089	683	808	39	-47	-442	-268	-100	-650
Domestic	-95	-105	227	537	885	1,275	1,081	863	1,353
Memorandum items:									
Balance of the central Gov. (incl. grants, excl. priv.)	-1,005	-917	-1,043	-910	-938	-933	-913	-863	-803
Central government primary balance	-109	337	-131	424	166	229	322	452	581
Central govt primary balance (excl. grants & priv.)	-199	-120	-216	15	-43	29	122	252	381
General government debt 2/	18,038	18,403	19,661	20,878	21,795	22,668	23,528	24,335	25,079
o/w domestic	6,774	6,715	7,155	7,657	8,415	9,571	10,554	11,338	12,630
external	11,264	11,688	12,506	13,222	13,380	13,097	12,974	12,997	12,449
Nominal GDP	28,741	29,890	32,261	35,255	37,994	41,426	45,198	49,394	53,962
Nominal nonagricultural GDP	25,411	26,804	28,373	30,827	33,582	36,715	40,170	44,031	48,239

Source: Tunisian authorities and staff estimates.

1/ Includes special funds, *fonds de concours* . Does not include the social security system (CSS).

2/ Gross debt: includes debt held by social security funds (CSS); excludes debt of public enterprises.

Table 3. Tunisia: Central Government Financial Operations, 2001–09 1/ (concluded)

	2001	2002	Est. 2003	Projections 2004	2005	2006	2007	2008	2009
				(Percent of GDP)					
Total revenue and grants and privatization	24.3	25.9	23.9	24.6	23.3	23.2	23.2	23.2	23.1
Total revenue	24.0	24.4	23.7	23.4	22.8	22.7	22.7	22.7	22.7
Tax revenue	21.6	21.5	20.6	20.4	20.4	20.5	20.6	20.7	20.8
o/w income taxes	6.4	6.8	6.7	6.7	6.7	6.7	6.8	6.8	6.9
VAT	6.7	6.3	6.2	6.3	6.4	6.6	6.7	6.9	7.0
trade taxes	2.3	2.0	1.7	1.6	1.5	1.4	1.3	1.2	1.1
Nontax revenue	2.4	2.9	3.0	3.0	2.3	2.2	2.1	2.0	1.9
Capital income	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	27.8	27.9	27.1	26.2	25.5	25.2	25.0	24.7	24.4
Total expenditure	27.4	27.5	26.7	26.2	25.5	25.2	25.0	24.7	24.4
Current expenditure	19.7	20.1	19.6	19.5	18.7	18.4	18.0	17.6	17.2
Wages and salaries	11.8	12.2	12.2	12.0	12.0	11.8	11.6	11.3	11.1
Goods and services	2.2	2.1	2.0	1.8	1.8	1.8	1.8	1.8	1.8
Interest payments	3.1	3.1	2.8	2.8	2.6	2.6	2.5	2.5	2.4
domestic	1.4	1.3	1.1	1.1	1.1	1.1	1.1	1.1	1.1
external	1.7	1.8	1.7	1.7	1.6	1.5	1.4	1.3	1.3
Transfers and subsidies	2.6	2.7	2.5	2.5	2.3	2.2	2.1	2.0	1.9
Other expenditure (nonallocated)	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Capital expenditure	7.8	7.5	7.1	6.7	6.8	6.9	7.0	7.1	7.2
Direct investment	4.7	4.4	4.1	4.0	4.1	4.2	4.3	4.4	4.5
Capital transfers and equity	3.1	3.1	3.0	2.7	2.7	2.7	2.7	2.7	2.7
Net lending	0.4	0.3	0.4	0.1	0.0	0.0	0.0	0.0	0.0
Central Govt deficit (-) (excl. grants & priv.)	-3.8	-3.5	-3.5	-2.8	-2.8	-2.5	-2.2	-2.0	-1.7
Grants	0.3	0.4	0.2	0.2	0.3	0.2	0.2	0.2	0.2
Privatization Proceeds	0.0	1.1	0.0	0.9	0.3	0.2	0.2	0.2	0.2
Central Govt deficit (-) (incl. grants & priv.)	-3.5	-1.9	-3.2	-1.6	-2.2	-2.0	-1.8	-1.5	-1.3
Financing	3.5	1.9	3.2	1.6	2.2	2.0	1.8	1.5	1.3
Foreign	3.8	2.3	2.5	0.1	-0.1	-1.1	-0.6	-0.2	-1.2
Domestic	-0.3	-0.4	0.7	1.5	2.3	3.1	2.4	1.7	2.5
Memorandum items:									
Balance of the central Gov. (incl. grants, excl priv)	-3.5	-3.1	-3.2	-2.6	-2.5	-2.3	-2.0	-1.7	-1.5
Central government primary balance	-0.4	1.1	-0.4	1.2	0.4	0.6	0.7	0.9	1.1
Central govt primary balance (excl. grants & priv.)	-0.7	-0.4	-0.7	0.0	-0.1	0.1	0.3	0.5	0.7
Central government debt 2/	62.8	61.6	60.9	59.2	57.4	54.7	52.1	49.3	46.5
o/w domestic	23.6	22.5	22.2	21.7	22.1	23.1	23.3	23.0	23.4
external	39.2	39.1	38.8	37.5	35.2	31.6	28.7	26.3	23.1

Source: Tunisian authorities and staff estimates.

1/ Includes special funds, *fonds de concours* . Does not include the social security system (CSS).

2/ Gross debt: includes debt held by social security funds (CSS); excludes debt of public enterprises.

Table 4. Tunisia : Monetary Survey, 2000–04 1/

	2000	2001	2002	2003	2004
	(in millions of Tunisia dinars)				
Net Foreign Assets	1,380.7	1,643.7	1,946.3	2,314.7	2,672.4
BCT	2,295.5	2,663.1	2,995.2	3,515.9	3,968.2
Banking system	-914.8	-1,019.3	-1,048.8	-1,201.2	-1,295.8
Net Domestic Assets	12,796.0	13,986.4	14,387.7	15,136.9	16,399.1
Domestic credit	17,093.6	18,281.6	19,411.1	20,420.2	21,796.3
Net credit to government	1,809.5	1,243.2	1,269.1	1,159.8	1,059.8
Credit to the economy	15,284.1	17,038.4	18,142.0	19,260.4	20,736.5
Other items net	-4,297.6	-4,295.2	-5,023.4	-5,283.2	-5,397.1
Broad Money (M3) 2/	14,176.6	15,630.1	16,334.1	17,451.7	19,071.5
Currency in circulation	2,228.6	2,377.8	2,518.6	2,664.0	2,911.3
Deposits	11,948.0	13,252.3	13,815.5	14,787.6	16,160.2
	(annual percentage change)				
Net Foreign Assets	-23.7	19.1	18.4	18.9	15.5
Net Domestic Assets	21.2	9.3	2.9	5.2	8.3
Domestic credit	30.7	7.0	6.2	5.2	6.7
Net credit to government	132.5	-31.3	2.1	-8.6	-8.6
Credit to the economy	24.2	11.5	6.5	6.2	7.7
Broad money (M3)	14.7	10.3	4.5	6.8	9.3
Nominal GDP	8.2	7.7	4.0	7.9	9.3
	(change in percent of beginning of year broad money)				
Net Foreign Assets	-3.5	1.9	1.9	2.3	2.0
Net Domestic Assets	18.1	8.4	2.6	4.6	7.2
Domestic credit	32.5	8.4	7.2	6.2	7.9
Net credit to government	8.3	-4.0	0.2	-0.7	-0.6
Credit to the economy	24.1	12.4	7.1	6.8	8.5
Other items net	-14.3	0.0	-4.7	-1.6	-0.7
Broad money	14.7	10.3	4.5	6.8	9.3
	(in millions of dollars)				
Gross official international reserve	1,792	2,011	2,305	2,948	3,225

Source: BCT and Fund staff estimates.
1/ BCT and deposit money banks.
2/ Deposits exclude postal deposits (CCP) and enterprises and individuals' deposits at BCT.

Table 5. Tunisia: Central Bank Balance Sheet, 2000–04

	2000	2001	2002	2003	Proj 2004
	(in millions of dinars unless otherwise indicated)				
Net foreign assets	2,295	2,663	2,995	3,516	3,968
Assets	2,557	2,935	3,134	3,629	4,087
Liabilities	261	272	139	113	119
Net domestic credit	369	490	222	-126	-263
Domestic credit (net)	376	611	213	-69	-33
Net credit to government 1/	-73	-244	-290	-504	-304
Credit to banks	449	854	503	435	271
Other items net	-7	-121	8	-57	-230
Reserve Money 2/	2,664	3,153	3,217	3,390	3,705
Currency in circulation	2,229	2,378	2,519	2,664	2,911
Currency held by banks	146	144	139	139	152
Bank deposits	289	631	559	587	641
Memorandum items:					
Reserve money growth (12-month percentage change)	-4.7	18.3	2.0	5.4	9.3
M3 money multiplier (deposit money banks)	5.3	5.0	5.1	5.1	5.1
M3 Velocity (deposit money banks)	1.882	1.839	1.830	1.849	1.849
Deposit money banks' reserve to deposit ratio	2.4	4.8	4.0	4.0	4.0
Currency to deposit ratio (in percent)	18.7	17.9	18.2	18.0	18.0

Source: Central Bank of Tunisia and Fund staff estimates.
1/ Excludes subscription to IMF/AMF
2/ Excludes deposits of development banks, other financial institutions, individuals and nonfinancial enterprises.

Table 6. Tunisia: Indicators of External Vulnerability, 2000–04

	2000	2001	2002	Est. 2003	Proj. 2004
Balance of payments					
Exports (percent change, 12-month basis in U.S. dollars)	-0.4	13.2	3.8	17.1	11.0
Imports (percent change, 12-month basis in U.S. dollars)	1.0	11.2	-0.2	14.7	9.8
Exports of goods, f.o.b. (volume percent change)	7.3	15.7	1.9	7.2	0.9
Imports of goods, f.o.b. (volume percent change)	6.5	13.6	-2.4	3.4	0.6
Terms of trade (percent change, 12 months basis)	-2.1	-0.2	-0.4	-1.5	0.7
Trade balance (in percent of GDP)	-11.6	-12.0	-10.1	-9.1	-8.5
Current account balance (in percent of GDP)	-4.2	-4.3	-3.5	-2.9	-2.5
Capital and financial account balance (in percent of GDP)	3.0	5.6	4.2	4.4	3.3
Short-term foreign assets and liabilities of the banking and corporate sector					
Gross official reserves (in billions of $)	1.8	2.0	2.3	3.0	3.2
Gross official reserves (in months of imports goods & services, cif)	2.4	2.3	2.7	3.0	2.9
Central bank short-term foreign liabilities (in billions of $)	0.2	0.2	0.1	0.1	0.1
External debt and debt service					
External debt (in billions of $)	11.4	11.6	13.7	16.1	16.2
Medium and long-term public debt (in billions of $)	9.9	10.2	12.1	14.3	14.4
Short-term debt (in billions of $) 1/	1.5	1.4	1.6	1.8	1.8
Total external debt /GDP (percent)	58.4	58.1	65.2	64.4	57.4
Medium and long-term public debt/GDP (in percent)	51.0	51.2	57.5	57.0	52.2
Short-term debt/GDP (in percent) 1/	7.5	6.9	7.8	7.4	6.4
Reserves/total short term external debt (percent)	125.8	144.2	142.7	161.8	176.7
excluding nonresidents deposits	318.6	436.2	392.6	428.6	445.3
Reserves/short term debt including current amortization (percent)	65.0	85.6	82.8	100.0	93.9
excluding nonresidents deposits	94.5	142.2	131.3	162.6	138.1
Debt service ratio (debt service as percent of exports GNFS)	22.6	15.6	17.2	15.1	19.0
External interest payments (as percent of exports GNFS)	6.0	5.1	5.5	5.3	5.6
External amortization payments (as percent of exports GNFS)	16.5	10.5	11.7	9.9	13.4
Exchange rate (per U.S. dollar, period average)	1.37	1.44	1.42	1.29	...
REER appreciation (+, percent change 12 months basis)	-1.7	-2.4	-1.1	-4.1	...
Financial market indicators					
Stock market index 2/	1,443	1,267	1,119	1250	1,332
Foreign currency debt rating 3/	BBB	BBB	BBB	BBB	BBB
Spread of benchmark bonds (basis points, end of period)	130	170	230	114	…

Sources: Tunisian authorities, and Fund staff estimates.

1/ Short-term external debt (up to one year) includes nonresidents deposits and excludes commercial debt.

2/ TUNINDEX. (1000 = 4/1/1998). 2004 is for September 10, 2004.

3/ S&P long-term foreign currency rating.

Table 7. Tunisia: Medium-Term Growth Scenario, 2002–09

	2002	2003	2004	2005	2006	2007	2008	2009
				(In percent)				
Real GDP growth	1.7	5.6	5.6	5.0	5.9	6.0	6.4	6.4
Agriculture 1/	-11.0	21.5	9.0	-3.0	4.0	4.0	4.0	4.0
Nonagriculture	3.5	3.6	5.1	6.2	6.2	6.3	6.7	6.7
Unemployment rate	14.9	14.3	13.8	13.8	13.2	12.6	11.7	10.9
Inflation	2.8	2.8	3.4	2.7	2.5	2.6	2.6	2.5
Real export growth 2/	-2.2	5.6	2.7	5.1	5.8	5.8	5.7	5.3
				(In percent of GDP)				
Gross national savings	21.6	22.2	22.0	21.6	21.8	22.0	22.3	22.4
General government 3/	4.7	4.0	4.3	4.7	5.0	5.2	5.6	5.9
Rest of the economy	16.9	18.1	17.7	16.9	16.8	16.7	16.7	16.5
Gross investment	25.2	25.1	24.5	24.6	24.8	24.8	25.1	25.2
General government	7.5	7.2	6.7	6.8	6.9	7.0	7.1	7.2
Rest of the economy	17.7	17.8	17.7	17.8	17.8	17.8	18.0	17.9
Savings-investment gap	-3.5	-2.9	-2.5	-3.0	-3.0	-2.8	-2.9	-2.7
Consolidated government	-2.8	-3.2	-2.5	-2.1	-2.0	-1.8	-1.6	-1.4
Rest of the economy	-0.7	0.3	0.0	-0.8	-1.0	-1.0	-1.3	-1.4
Memorandum items:								
Balance of the general government	-2.8	-3.2	-2.5	-2.1	-2.0	-1.8	-1.6	-1.4
External current account	-3.5	-2.9	-2.5	-3.0	-3.0	-2.8	-2.9	-2.7
Gross fixed capital formation	25.2	23.3	22.9	23.4	23.7	23.2	23.9	24.0

Source: IMF staff estimates from 2003.

1/ Based on average growth of agricultural output from 2001 onwards.

2/ Goods and nonfactor services.

3/ Includes social security, excludes privatization receipts.

Table 8. Tunisia: Balance of Payments, 2002–09

(In millions of U.S. dollars)

		Est.	Projections					
	2002	2003	2004	2005	2006	2007	2008	2009
Current account	-746	-730	-701	-884	-963	-990	-1,082	-1,125
Trade balance	-2,124	-2,270	-2,401	-2,597	-2,832	-3,032	-3,299	-3,528
Exports	6,857	8,027	8,909	9,160	9,677	10,307	10,998	11,698
Energy	641	801	798	762	666	616	585	540
Non-energy	6,215	7,226	8,110	8,398	9,011	9,691	10,413	11,158
Imports	-8,980	-10,297	-11,310	-11,757	-12,509	-13,339	-14,297	-15,226
Energy	-863	-1,130	-1,150	-1,152	-1,129	-1,156	-1,204	-1,225
Non-energy	-8,117	-9,166	-10,160	-10,606	-11,380	-12,183	-13,093	-14,001
Services and Transfers (net)	1,378	1,539	1,700	1,714	1,869	2,041	2,217	2,403
Nonfactor	1,301	1,362	1,617	1,703	1,848	1,999	2,142	2,286
o/w Tourism	1,422	1,477	1,743	1,853	2,003	2,164	2,332	2,512
Factor Services and Transfers (net)	77	177	83	11	21	42	75	117
o/w Workers' remittances	1,070	1,250	1,359	1,415	1,479	1,547	1,616	1,687
o/w Interest payments on external debt	-516	-572	-681	-836	-956	-995	-1,032	-1,068
Capital and financial account	885	1,113	919	1,023	1,179	1,188	1,408	1,528
Excluding grants	802	1,047	815	906	1,062	1,072	1,293	1,414
Capital account	76	59	96	109	108	108	107	106
Financial account	810	1,054	823	914	1,070	1,080	1,301	1,422
Direct foreign investment (net)	801	553	821	709	769	835	906	985
Medium and long term loans (net)	766	806	178	289	478	497	508	481
Disbursement	1,874	1,874	1,802	1,607	2,084	1,983	2,037	2,191
Amortization	-1,108	-1,068	-1,624	-1,318	-1,606	-1,486	-1,529	-1,710
Short term capital	-723	-271	-176	-84	-177	-251	-114	-44
Errors and omissions	-34	-34	0	0	0	0	0	0
Overall balance	140	383	218	140	215	197	325	403
Changes in gross reserves 1/	-349	-653	-193	-153	-225	-203	-328	-405
Use of IMF resources	0	0	0	0	0	0	0	0
Other assets, net (increase -)	-349	-653	-193	-153	-225	-203	-328	-405
Memorandum items:								
Current account balance/GDP (in percent)	-3.5	-2.9	-2.5	-3.0	-3.0	-2.8	-2.9	-2.7
Reserves (in billions of $)	2.3	3.0	3.2	3.3	3.6	3.8	4.1	4.5
Reserves in months of imports of goods &services	2.7	3.0	2.9	3.0	3.0	2.9	3.0	3.1
External medium-and long-term debt (in billions of $)	12.1	14.3	14.4	14.8	15.4	15.9	16.5	17.0
External medium-and long-term debt/GDP (in percent)	57.5	57.0	51.0	50.0	47.9	45.8	43.7	41.5
External Short-term debt (in billions of $) 2/	1.6	1.8	1.8	1.9	1.9	2.0	2.1	2.2
External short-term debt/GDP (in percent) 2/	7.8	7.4	6.4	6.3	6.1	5.8	5.6	5.4
Debt Service Ratio (as percent XGS, incl IMF)	17.2	15.1	19.0	17.1	19.1	17.3	16.7	17.0
Real goods export growth (in percent)	1.9	7.2	0.9	4.6	5.7	5.8	5.7	5.1
Non-energy	-0.8	5.4	3.3	5.2	7.3	7.0	6.6	6.1
Real goods import growth (in percent)	-2.4	3.4	0.6	5.3	7.1	6.4	6.1	5.4
Non-energy	-4.2	0.6	1.5	5.3	7.3	6.5	6.1	5.4

Sources: Tunisian authorities; and Fund staff estimates and projections.
1/ Differs from the overall balance because of valuation effects.
2/ Short-term external debt includes non-residents deposits and excludes commercial debt.

Table 9. Tunisia: Public Sector Debt Sustainability Framework, 1999–2009

(In percent of GDP, unless otherwise indicated)

		1999	2000	2001	2002	2003	10-Year Historical Average	10-Year Standard Deviation	Projections 2004	2005	2006	2007	2008	2009	
	I. Baseline Projections														**Debt-stabilizing primary balance 10/**
1	Public sector debt 1/	60.0	60.8	62.8	61.6	60.9			59.2	57.4	54.7	52.1	49.3	46.5	**-1.8**
	o/w foreign-currency denominated	38.8	38.1	39.2	39.1	38.8			37.5	35.2	31.6	28.7	26.3	23.1	
2	Change in public sector debt	3.7	0.8	2.0	-1.2	-0.6			-1.7	-1.9	-2.6	-2.7	-2.8	-2.8	
3	Identified debt-creating flows (4+7+12)	2.2	2.5	0.5	-4.4	-4.9			-1.5	-2.1	-2.8	-2.8	-2.9	-2.8	
4	Primary deficit	-1.2	-0.1	-0.4	-0.3	0.4			-0.4	-0.5	-0.6	-0.7	-0.9	-1.0	
5	Revenue and grants	29.5	29.5	29.8	30.4	29.7			29.5	28.9	28.8	28.8	28.8	28.8	
6	Primary (noninterest) expenditure	28.3	29.4	29.4	30.1	30.1			29.1	28.4	28.2	28.1	27.9	27.8	
7	Automatic debt dynamics 2/	3.4	2.9	0.9	-3.0	-5.3			-0.2	-1.4	-2.0	-1.8	-1.8	-1.7	
8	Contribution from interest rate/growth differential 3/	-1.4	-1.1	-1.3	0.6	-1.7			-2.3	-1.6	-2.2	-2.1	-2.0	-1.8	
9	Of which contribution from real interest rate	1.7	1.5	1.4	1.7	1.5			0.8	1.1	0.9	0.9	1.1	1.1	
10	Of which contribution from real GDP growth	-3.1	-2.6	-2.7	-1.0	-3.2			-3.1	-2.7	-3.1	-3.0	-3.0	-2.9	
11	Contribution from exchange rate depreciation 4/	4.8	4.0	2.2	-3.6	-3.6			2.2	0.3	0.2	0.2	0.2	0.1	
12	Other identified debt-creating flows	0.0	-0.3	0.0	-1.1	0.0			-0.9	-0.3	-0.2	-0.2	-0.2	-0.2	
13	Privatization receipts (negative)	0.0	-1.3	0.0	-1.1	0.0			-0.9	-0.3	-0.2	-0.2	-0.2	-0.2	
14	Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
15	Other (specify, e.g. bank recapitalization)	0.0	1.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
16	Residual, including asset changes (2-3) 5/	1.5	-1.7	1.5	3.2	4.3			-0.2	0.3	0.2	0.1	0.1	0.1	
	Public sector debt-to-revenue ratio 1/	203.4	206.3	210.6	202.7	204.9			200.8	198.6	189.9	180.8	171.1	161.6	
	Gross financing need 6/	5.4	8.4	5.8	6.3	5.9			6.3	4.9	5.4	4.4	3.6	3.7	
	in billions of U.S. dollars	1.1	1.6	1.2	1.3	1.5			1.8	1.4	1.7	1.5	1.4	1.5	
	Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
	Real GDP growth (in percent)	6.1	4.7	4.9	1.7	5.6	4.6	1.7	5.6	5.0	5.9	6.0	6.4	6.4	5.9
	Average nominal interest rate on public debt (in percent) 7/	6.6	6.0	5.5	5.1	4.9	6.3	1.0	5.1	4.8	4.9	5.0	5.2	5.3	5.0
	Average real interest rate (nominal rate minus change in GDP deflator, in percent)	3.5	2.8	2.6	2.8	2.7	2.8	0.6	1.6	2.1	1.9	2.1	2.5	2.6	2.1
	Nominal appreciation (increase in US dollar value of local currency, in percent)	-12.1	-9.6	-5.7	10.1	10.4	-1.1	9.0	-5.5	-0.7	-0.6	-0.7	-0.6	-0.5	-1.4
	Inflation rate (GDP deflator, in percent)	3.1	3.2	2.8	2.3	2.2	3.5	1.0	3.5	2.7	2.9	2.9	2.7	2.7	2.9
	Growth of real primary spending (deflated by GDP deflator, in percent)	5.1	8.7	5.0	4.0	5.6	4.4	3.7	2.1	2.2	5.3	5.5	5.8	5.8	4.5
	Primary deficit	-1.2	-0.1	-0.4	-0.3	0.4	-0.3	0.7	-0.4	-0.5	-0.6	-0.7	-0.9	-1.0	-0.7
	II. Stress Tests for Public Debt Ratio														**Debt-stabilizing primary balance 10/**
	A. Alternative Scenarios														
	A1. Key variables are at their historical averages in 2005-09 8/								59.2	58.1	56.9	55.7	54.4	53.2	**-1.0**
	A2. No policy change (constant primary balance) in 2005-09								59.2	59.0	57.5	56.0	54.5	53.1	**-1.2**
	B. Bound Tests														
	B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006								59.2	58.4	56.8	54.0	51.2	48.3	**-1.8**
	B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								59.2	60.6	63.0	62.5	61.7	60.9	**-2.3**
	B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006								59.2	59.0	57.9	55.2	52.3	49.4	**-1.9**
	B4. Combination of 2-4 using one standard deviation shocks								59.2	60.1	60.9	58.0	55.0	52.0	**-2.0**
	B5. One time 30 percent real depreciation in 2005 9/								59.2	74.8	71.5	68.3	64.9	61.6	**-2.3**
	B6. 10 percent of GDP increase in other debt-creating flows in 2005								59.2	67.4	64.4	61.4	58.3	55.2	**-2.1**

1/ Gross debt of the General Government (Central Government and Social Security system).

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the numerator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ The volatility of the residual is exaggerated by the calculation of the exchange rate effect, which assumes that all foreign debt is denominated in U.S. dollars. This effect is particularly pronounced in 2003 when the Tunisian dinar appreciated against the U.S. dollar, while depreciating against all other major currencies.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ Derived as nominal interest expenditure divided by previous period debt stock.

8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

10/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

Table 10. Tunisia: External Debt Sustainability Framework, 1999–2009

(In percent of GDP, unless otherwise indicated)

	1999	2000	2001	2002	2003			Projections 2004	2005	2006	2007	2008	2009	
I. Baseline Projections														Debt-stabilizing non-interest current account 6/
1 External debt	58.2	60.0	58.1	65.2	64.4			57.4	56.3	54.0	51.6	49.3	46.9	-3.6
2 Change in external debt	-2.4	1.8	-1.9	7.1	-0.8			-7.0	-1.1	-2.3	-2.3	-2.4	-2.4	
3 Identified external debt-creating flows (4+8+9)	-2.3	4.4	0.6	-3.2	-9.7			-3.6	-2.1	-2.4	-2.4	-2.5	-2.5	
4 Current account deficit, excluding interest payments	-0.6	1.4	1.9	1.1	0.6			0.1	0.2	0.0	0.0	0.1	0.1	
5 Deficit in balance of goods and services	1.9	3.3	4.2	3.9	3.6			2.8	3.0	3.1	3.0	3.1	3.0	
6 Exports	42.1	43.9	47.3	44.9	43.3			43.0	42.5	41.7	41.2	40.6	39.7	
7 Imports	44.0	47.2	51.5	48.9	46.9			45.8	45.5	44.8	44.1	43.7	42.8	
8 Net non-debt creating capital inflows (negative)	-1.7	-3.8	-2.1	-3.8	-2.2			-2.9	-2.3	-2.3	-2.3	-2.3	-2.3	
9 Automatic debt dynamics 1/	0.1	6.8	0.9	-0.4	-8.2			-0.8	0.1	-0.1	-0.1	-0.3	-0.3	
10 Contribution from nominal interest rate	2.8	2.9	2.4	2.5	2.3			2.4	2.8	3.0	2.9	2.7	2.6	
11 Contribution from real GDP growth	-3.5	-2.9	-2.8	-0.9	-3.1			-3.2	-2.7	-3.1	-3.0	-3.0	-2.9	
12 Contribution from price and exchange rate changes 2/	0.8	6.8	1.3	-2.0	-7.4			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-0.1	-2.6	-2.5	10.3	8.9			-3.5	1.0	0.1	0.1	0.1	0.1	
External debt-to-exports ratio (in percent)	138.5	136.6	122.9	145.1	148.7			133.4	132.5	129.4	125.4	121.4	118.0	
Gross external financing need (in billions of US dollars) 4/	3.1	3.7	3.4	3.2	3.4			4.2	4.0	4.4	4.4	4.6	5.0	
in percent of GDP	14.8	19.2	17.1	15.4	13.7			14.8	13.5	13.8	12.7	12.3	12.1	
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	6.1	4.7	4.9	1.7	5.6	4.6	1.7	5.6	5.0	5.9	6.0	6.4	6.4	5.9
GDP deflator in US dollars (change in percent)	-1.3	-10.5	-2.1	3.5	12.8	1.2	7.6	6.8	-0.1	2.3	2.3	2.0	2.1	2.6
Nominal external interest rate (in percent)	4.8	4.6	4.2	4.4	4.2	5.1	0.8	4.2	5.2	5.7	5.7	5.7	5.7	5.4
Growth of exports (US dollar terms, in percent)	3.4	-2.1	10.5	0.0	14.7	6.8	7.6	11.9	3.7	6.4	7.0	7.0	6.3	7.1
Growth of imports (US dollar terms, in percent)	1.0	0.6	12.0	-0.2	14.4	6.0	7.0	10.0	4.3	6.6	6.9	7.4	6.4	6.9
Current account balance, excluding interest payments	0.6	-1.4	-1.9	-1.1	-0.6	-0.5	0.9	-0.1	-0.2	0.0	0.0	-0.1	-0.1	-0.1
Net non-debt creating capital inflows	1.7	3.8	2.1	3.8	2.2	2.6	0.9	2.9	2.3	2.3	2.3	2.3	2.3	2.4
II. Stress Tests for External Debt Ratio														Debt-stabilizing non-interest current account 6/
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 5/								57.4	55.9	54.9	53.8	52.7	51.5	-2.9
B. Bound Tests														
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								57.4	57.1	55.3	52.9	50.5	48.1	-3.6
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								57.4	58.4	58.6	56.1	53.5	50.9	-3.9
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								57.4	65.5	74.8	71.5	68.2	64.8	-4.9
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								57.4	58.5	58.5	56.1	53.6	51.1	-3.7
B5. Combination of 2-5 using one standard deviation shocks								57.4	63.1	69.7	66.7	63.8	60.7	-4.5
B6. One time 30 percent nominal depreciation in 2005								57.4	78.2	75.0	71.7	68.4	65.0	-5.0

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 11. Tunisia: External Sustainability Framework—Gross External Financing Need, 1999–2009

						Projections					
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Gross external financing need in billions of U.S. dollars 1/	3.1	3.7	3.4	3.2	3.4	4.2	4.0	4.4	4.4	4.6	5.0
in percent of GDP	14.8	19.2	17.1	15.4	13.7	14.8	13.5	13.8	12.7	12.3	12.1
Gross external financing need in billions of U.S. dollars 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2005-09 3/						4.2	4.1	4.5	4.5	4.7	5.0
B. Bound Tests											
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006						4.2	4.3	4.7	4.5	4.8	5.1
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						4.2	4.0	4.4	4.4	4.6	5.0
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006						4.2	4.0	4.4	4.4	4.6	4.9
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006						4.2	4.7	5.4	4.8	5.0	5.4
B5. Combination of 2-5 using one standard deviation shocks						4.2	4.5	5.0	4.7	4.9	5.2
B6. One time 30 percent nominal depreciation in 2005						4.2	4.0	4.4	4.4	4.6	4.9
Gross external financing need in percent of GDP 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2005-09 3/						14.8	13.7	14.2	13.5	13.2	13.3
B. Bound Tests											
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006						14.8	14.4	14.6	13.0	12.6	12.4
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						14.8	14.0	15.0	13.8	13.3	13.1
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006						14.8	15.7	19.1	17.6	17.0	16.7
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006						14.8	15.9	17.0	13.8	13.3	13.1
B5. Combination of 2-5 using one standard deviation shocks						14.8	16.6	19.1	16.4	15.9	15.6
B6. One time 30 percent nominal depreciation in 2005						14.8	18.7	19.2	17.7	17.0	16.7

1/ Defined as non-interest current account deficit, plus interest and amortization on medium- and long-term debt, plus short-term debt at end of previous period.
2/ Gross external financing under the stress-test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.
3/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

Tunisia: Fund Relations

(As of July 31, 2004)

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

II. **General Resources Account:**	SDR Million	%Quota
Quota	286.50	100.0
Fund Holdings of Currency	266.31	92.95
Reserve position in Fund	20.20	7.05

III. **SDR Department:**	SDR Million	%Allocation
Net cumulative allocation	34.24	100.0
Holdings	13.33	38.93

IV. **Outstanding Purchases and Loans:** None

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):

	Forthcoming				
	2004	2005	2006	2007	2008
Principal					
Charges/Interest	0.18	0.40	0.40	0.40	0.40
Total	0.18	0.40	0.40	0.40	0.40

Exchange Rate Arrangement and Exchange System

Tunisia accepted the obligations of Article VIII Sections 2(a),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 that Tunisia maintains (a) a multiple currency practice resulting from honoring exchange rate guarantees extended prior to August 1988 to development banks, which will automatically expire after the existing commitments have matured; and (b) 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).

Since March 1, 1994, the market rates are determined in an interbank foreign exchange market. On September 10, 2004, the interbank rate of the dinar vis-à-vis the U.S. dollar was US$1=TD 1.2614, equivalent to SDR 1=TD 1.846.

Article IV Consultation

Tunisia is on the 12-month cycle. The last discussions of the Article IV consultation were held in Tunis from May 6–20, 2003 and the consultation was concluded by the Executive Board on July 25, 2003.

Technical Assistance

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 11–21, 1999: STA—quarterly national accounts.

May 13–18, 1999: STA—SDDS.

October 12–15, 1999: MAE—debt management practices.

October 17–27, 2000: STA—quarterly national accounts.

October 25–31, 2000; STA—SDDS meta data finalization.

December 17–21, 2001: MAE—management of central bank liquidity.

December 12–19, 2003: LEG—AML/CFT.

May 18–19, 2004: MFD—technical assistance needs assessment.

Resident Representative: None.

TUNISIA: FINANCIAL RELATIONS WITH THE WORLD BANK

(As of August 31, 2004)

1. The World Bank's portfolio in Tunisia has a total of 16 active operations and 113 closed loans, of which 10 International Development Agency (IDA) credits amounting to US$75.2 million net of cancellations. Cumulative net commitments represent US$4.9 billion. Of this total, US$2.8 billion has been repaid. Net commitments for the 16 current investment operations amount to about US$0.8 billion.

2. A new Country Assistance Strategy (CAS) was approved by the Board on June 3, 2004. It proposes to assist the Government of Tunisia in addressing three key challenges: (a) strengthen the business environment to support the development of a more competitive, internationally integrated private sector and improve competitiveness of the Tunisian economy; (b) enhance skills and employability of graduates and labor force in a knowledge economy; and (c) improve the quality of social services through enhanced efficiency of public expenditures.

3. Bank lending is a mix of long-term investments in infrastructure and social sector financing, and development policy lending to support reforms at the sector and macroeconomic levels. Recent loans include an ICT Sector Development Project ($13.3 million) approved by the Board on July 1, 2004, a second-phase Export Development Project ($37.6 million) approved on June 28, 2004 and a second-phase Education Quality Improvement Project ($130.3 million) approved on March 8, 2004.

4. Preparation of a new Development Policy Lending operation (ECAL IV) has begun, jointly with the African Development Bank and the European Union. The program is intended to support mutually reinforcing reforms to improve competitiveness and promote sustained growth by: (a) strengthening Tunisia's investment climate and expanding opportunities for private investment; (b) reinforcing the financial sector's soundness and its capacity to finance productive investment; and (c) maintaining a sound and reactive medium-term macroeconomic framework.

5. Despite the fact that the quality of the portfolio is satisfactory, cumbersome procurement procedures and slow implementation pace—especially in the rural development and education portfolios—are affecting the portfolio performance. A Country Portfolio Performance Review (CPPR) was carried out in 2003 followed by a Country Procurement Assessment Review and an Independent Procurement Review. The various recommendations from these activities are being discussed with Government, and in some cases, already being carried out.

6. Recent analytical work includes studies of employment challenges, poverty trends, private participation in infrastructure, public debt management, and tourism. A Development Policy Review was prepared in 2003 in order to assess Tunisia's key challenges and policy

priorities in the years ahead. This provided the analytical basis for the new Country Assistance Strategy and is intended to inform the Government's thinking on the next five-year plan (2007–2011). Other recent work includes Country Financial Accountability and Procurement Assessments, and analytical work in specific sectors such as education.

7. The World Bank is currently preparing a rural sector-wide review and a Public Expenditures Review with special focus on performance-oriented budgeting. In addition, technical assistance is provided on a regular basis on issues such as public debt management and the promotion of the knowledge-based economy. The Bank will also provide multi-year support on employment and labor market issues as part of a Programmatic Economic and Sector Work.

Tunisia: Financial Relations with the World Bank

(As of September 7, 2004)

	Total Net Commitments	Undisbursed Balance
	(In million of U.S. dollars)	
IBRD lending operations		
113 loans closed [1/]	4074.0	
16 active loans		
-MP Ozone Depleting Subs.	3.8	0.4
-Greater Tunis Sewerage	53	19.5
-Higher Education Reform Support I	80	29.2
-Agric. Support Services	21.3	24.4
-Water Sector Invt. Project	103	68.5
-Transport Sector Invt.	50	11.5
-GEF Protected Areas Mgmt.	5.1	4.8
-Cultural Heritage	17	20.8
-Education PAQSET I	99	39.0
-Export Development	35	9.21
-Transport Sector Invt. II	37.6	34.1
-NW Mountainous & Forestry Areas Devt.	34	38.0
-Municipal Devt. III	78.4	76.7
-Export Development II	36	37.6
-Education PAQSET II	130.3	121.9
-ICT Sector Development	13.1	13.3
Total active loans	796.7	548.8
Repayments [2/]	2,807.2	
Debt outstanding [2/]	1719.9	

	1999	2000	2001	2002	2003	2004	2005
Net lending by the World Bank (by fiscal year) [3/]							
Commitments	194	202	75.9	252.5	112.4	166.3	13.1
Disbursements	208.6	147.1	174.6	226.7	142.5	238.6	20.4
Debt service	270.6	246.5	223.1	229.8	258.0	305.1	22.5
Principal	175.9	163.1	146.3	149.6	175.9	224.8	17.3
Interest [5/]	94.7	83.4	76.8	80.2	82.1	80.3	5.2
Net transfer [6/]	-62	-99.4	-48.5	-3.1	-115.5	-66.5	-2.1

1/ Less cancellations, includes adjustment lending, does not include guarantees.
2/ As of August 31, 2004
3/ Fiscal years start July 1 and end June 30.
4/ Does not include US$184 million for guarantee on Jorf Lasfar electricity project
5/ Includes charges.
6/ Equal to disbursement minus debt service.

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. Tunisia subscribed to the SDDS in June 2001 and its metadata are posted on the Dissemination Standards Bulletin Board (DSBB).

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. Data on employment, unemployment, and wages should be collected and reported on a more frequent basis.

Government Finance

3. In addition to information reported in the SDDS, government finance data are collected by the staff at the time of the Article IV consultation mission. Regarding data for publication, GFS data up to 2002 are published in the *Government Finance Statistics Yearbook 2003* Data cover consolidated central government. Tunisia does not report monthly or quarterly data for publication in IFS.

Balance of Payments

4. Statistics for Tunisia's balance of payments (BOP) and international investment position (IIP) are compiled by the Central Bank of Tunisia (CBT), following the methodology of the *Balance of Payments Manual, Fifth Edition* (*BPM5)*. The BOP statistics are prepared on a quarterly basis and the IIP on an annual basis, complying with SDDS requirements. The CBT issues preliminary monthly statistics, mostly prepared on the basis of banks settlements with nonresidents. BOP statistics are generally adequate for annual surveillance, although greater detail on the financial account would be desirable. As an SDDS subscriber, Tunisia reports reserves data following the *International Reserves and Foreign Currency Liquidity—Operational Guidelines* (*Reserves Template*) since June 2001.

Monetary and Financial Statistics

5. Monetary and financial statistics are adequate for surveillance.

TUNISIA: CORE STATISTICAL INDICATORS

September 15, 2004

	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	Aug04	Apr04	Aug04	Aug04	Jul04	Aug04	Jul04	Jul04	Q1/04	2002 1/	Q4/03	Q4/03
Date received	Sep04	May04	Sep04	Sep04	Sep04	Sep04	Aug04	Aug04	Apr04	Apr04	Apr04	Apr04
Frequency of data	D	M	M	M	M	D	M	M	Q	A	Q	Q
Frequency of reporting	D	M	M/V	M/V	M/V	D	M/V	Q/V	Q/V	/V	Q/V	V
Source of data	Central Bank/ SDDS	Central Bank/ SDDS	Central Bank/ SDDS	Central Bank/ SDDS	Central Bank/ SDDS	Central Bank/ SDDS	Central Bank/ SDDS	Central Bank/ SDDS	Central Bank/ SDDS	Ministry Econ. Dev /SDDS	Central Bank/ SDDS	Ministry Econ. Dev. /SDDS
Mode of Reporting	Cable	Fax	Fax	Fax	STA rpt./ MED	STA rept./ MED	STA rept./ Mission	Fax/ Mission/ Annual report	Fax/ Mission/ Annual report	Fax/ Mission	Mission	Mission
Confidentiality	U	U	U	U	U	U	U	U	U	U	U	U
Frequency of Publication	D	M	M	M	M	D	M	M	Q	A	Q	Q

A= annually; D= daily; M= monthly; Q= quarterly; U= unrestricted; V= during mission; W= Weekly
1/ Central government, April 2004.

WORK PROGRAM

I. Article IV Consultation

Executive Board Meeting	October 2004
Staff visit	Early 2005

II. Technical Assistance and ROSC

STA multisector statistics mission.	2004

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IMF Concludes 2004 Article IV Consultation with Tunisia

On October 27, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tunisia.[1]

Background

Over the past decade, Tunisia's economic performance has been one of the strongest in the region, reflecting gradual but continuous structural reforms, well-targeted social policies, and prudent macroeconomic policies. Tunisia signed an Association Agreement with the EU (AAEU) in 1995, marking the beginning of a significant opening to trade with the EU. Fiscal and monetary discipline has contributed to macroeconomic stability, in the context of a real effective exchange rate (REER) targeting framework with controls on capital flows.

The strength of the Tunisian economy continued in 2003 and the short-term outlook is favorable. Favorable agriculture production and robust nonenergy exports contributed to high growth and a narrowing of the external current account deficit in 2003. A rebound in tourism, a pickup in European demand, and continued real depreciation of the dinar is projected to sustain this strength in 2004. Monetary policy remains prudent and inflation under control. Greater exchange rate flexibility and the appreciation of the euro vis-à-vis the US dollar have led to a depreciation of the dinar in real effective terms. This flexibility has improved Tunisia's competitiveness and helped strengthen its external position.

[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 October 27, 2004 Executive Board discussion based on the staff report.

On the fiscal front, a low tax buoyancy did not permit further consolidation in 2003, despite the recovery in economic activity. The central government deficit remained at 3.5 percent of GDP in 2003 (excluding grants and privatization receipts), about 0.8 percentage points higher than the budget target. Nevertheless, this allowed for a reduction in the public debt by 0.7 percentage points of GDP, to 61 percent. The 2004 budget deficit target of 2.8 percent of GDP is within reach thanks to measures on the VAT and on subsidies expenditures and higher-than-expected profit transfers from state-owned enterprises.

Banking sector indicators deteriorated further in 2003, in part due to difficult economic conditions in certain sectors such as tourism, as well as competitive pressures, which Tunisia is facing in the context of growing openness. NPLs as a share of bank assets increased by three percentage points to 24 percent in 2003. While these weaknesses do not pose systemic risks in the near term, current lending practices dampen Tunisia's growth potential by increasing the cost of capital.

Despite Tunisia's favorable economic performance, its objective of approaching lower-tier OECD income levels has not been met, and unemployment remains high. Meeting this challenge will require strengthening the macroeconomic policy framework and accelerating structural change. Regarding the former, the authorities are preparing to gradually open up the external capital account. To maintain a measure of monetary policy independence, the authorities have begun a gradual transition toward a floating exchange rate regime. They are also in the process of developing a new monetary policy framework, which should be implemented shortly.

On the structural side, the authorities are implementing reform supported by the World Bank, the African Development Bank, and the EU, under the Economic Competitiveness Adjustment Loan. Aside from banking sector weaknesses, impediments include a still restrictive trade regime (especially vis-à-vis non-EU countries), labor market rigidities, and a business climate not yet fully conducive to private sector dynamism. On trade, measures were taken in 2004 to lower and simplify MFN tariffs and streamline customs procedures.

Tunisia continues to improve the quality and dissemination of statistical data and increase the transparency of its economic policies. Tunisia has published all Executive Board documents and staff mission statements in recent years, and intend to publish the 2004 Article IV Staff Report and Selected Issues papers.

Executive Board Assessment

Executive Directors commended the Tunisian authorities for the success in maintaining the economy's resilience and strength, notwithstanding recent shocks and sluggish growth in Europe—Tunisia's main export market. Directors noted that forward-looking and outward-oriented structural policies, in conjunction with prudent macroeconomic management and well-targeted social policies, have put Tunisia among the leaders in the region in terms of growth and market-oriented reforms. They praised the authorities for maintaining close and productive dialogue with the Fund.

Directors noted that, while the economic outlook for 2005 remains favorable—underpinned by a rebound in tourism, agriculture, and exports—the main challenge for Tunisia is to solidify conditions for strong, sustainable growth to attain lower-tier OECD income levels and reduce unemployment. They therefore encouraged the authorities to take advantage of the current environment to accelerate reforms aimed at raising the economy's potential and creating a business environment conducive to private investment. Appropriate sequencing of these reforms while maintaining social cohesion will be key to the success of such efforts.

Directors welcomed the fact that the mix of monetary policy and gradual increase in exchange rate flexibility has helped improve external competitiveness and strengthen the external position. They agreed that the current monetary policy stance is appropriate, but encouraged the authorities to remain vigilant against price pressures as the economy expands, in order to safeguard the competitive gains that have been achieved thus far.

Directors endorsed the authorities' phased approach to liberalizing capital flows and plan to eventually float the dinar. They underlined the need to lay the groundwork for such a transition by strengthening the banking sector, reducing public debt, and deepening the development of money and foreign exchange markets. Directors welcomed the recent steps to increase the role of market forces in determining the exchange rate—including decisions to reduce the surrender requirement and to eliminate the requirement for banks to transfer foreign exchange balances to the central bank on a daily basis, the "nivellement"—and encouraged the authorities to discontinue posting bid/ask spreads for the exchange rate. They noted the considerable progress that has been made in developing a monetary framework aimed at price stability, which is a prerequisite for a floating exchange rate.

Directors expressed concern that banking sector weaknesses, especially the high level of nonperforming loans (NPLs) could potentially constitute a major vulnerability. They welcomed the steps taken recently to strengthen supervision and accounting standards, reduce NPLs, and increase provisioning. However, Directors noted that additional measures are needed and urged the authorities to adopt stricter provisioning rules, enforce sanctions against banks with insufficient provisioning or capital, and reduce the government's role in the financial sector. They also encouraged the authorities to broaden the banking sector reform agenda in line with the FSAP recommendations. In this connection, Directors welcomed the authorities' intention to request an update to the 2002 FSAP. They underscored the importance of consolidating the banking sector before any substantial progress is made toward an exchange rate float and capital account liberalization.

Directors commended the authorities' efforts to contain the negative impact of high oil prices on the 2004 budget and supported their intention to carry out a broad reform of the tax system, with technical assistance from the Fund. They stressed the need to adopt a budget for 2005 consistent with the objective of reducing the public debt-to-GDP ratio, especially external debt, over the medium term. This, together with prudent debt management, will help strengthen confidence in the currency. Directors urged the authorities to redouble their revenue-enhancing efforts, through improving tax collection and administration, phasing out tax exemptions, and widening the tax base. They also encouraged the authorities to undertake a reform of the subsidies system and to consider a broad-based civil service reform to enhance the efficiency of the public administration and contain the wage bill, while protecting allocations for health and education. In this regard, the planned introduction of a performance-based budgeting system should help guide budget decisions.

Directors commended the authorities' structural reform efforts and noted that emphasis should remain on enhancing the business climate, attracting foreign direct investment, and improving the regulatory framework. They welcomed, in particular, the progress in integrating trade with the European Union and the continued efforts to enhance regional integration within the Maghreb region. Directors nevertheless highlighted the benefits of accelerating trade liberalization on a multilateral basis, in terms of improved productivity and greater trade opportunities. To this end, they encouraged the authorities to continue lowering most-favored-nation tariffs within the 2005 budget law, and to reduce nontariff barriers, including by pursuing further reforms in customs administration, and liberalizing the distribution and transportation sectors. Directors welcomed the decision to study options for dismantling state import monopolies.

Directors noted that the recent measures to enhance labor market flexibility are important steps to reduce unemployment and support labor reallocation in response to changes in the economic structure. They encouraged the authorities to streamline labor regulations, continue to pursue active labor market policies, and explore further ways to enhance labor market flexibility, with a view to ensuring that growth translates into reduced unemployment.

Directors commended the authorities' record of transparency. They welcomed the ongoing efforts to improve the quality and dissemination of statistics within the framework of the Special Data Dissemination Standard (SDDS), as well as the intention to update the 1999 data ROSC.

Directors welcomed the recent creation of a Financial Intelligence Unit and the adoption of a law on anti-money laundering and combating the financing of terrorism (AML/CFT). They looked forward to the full implementation of the law, which is expected to contribute to a significant improvement in the country's AML/CFT regime.

Table 1. Tunisia: Selected Economic Indicators

	2000	2001	2002	Est. 2003	Proj. 2004
Production and income (percent change)					
Nominal GDP	8.2	7.7	4.0	7.9	9.3
Real GDP	4.7	4.9	1.7	5.6	5.6
GDP deflator	3.3	2.7	2.3	2.2	3.5
Consumer price index (CPI), average	3.0	1.9	2.8	2.8	3.4
Gross national savings (in percent of GDP)	23.1	23.5	21.6	22.2	22.0
Gross investment (in percent of GDP)	27.3	27.8	25.2	25.1	24.5
External sector (percent change)					
Exports of goods, f.o.b. (in $)	-0.4	13.2	3.8	17.1	11.0
Imports of goods, f.o.b. (in $)	1.0	11.2	-0.2	14.7	9.8
Exports of goods, f.o.b. (volume)	7.3	15.7	1.9	7.2	0.9
Import of goods, f.o.b. (volume)	6.5	13.6	-2.4	3.4	0.6
Trade balance (in percent of GDP)	-11.6	-12.0	-10.1	-9.1	-8.5
Current account, excl. grants (in percent of GDP)	-4.2	-4.3	-3.5	-2.9	-2.5
Terms of trade (deterioration -)	-2.1	-0.2	-0.4	-1.5	...
Real effective exchange rate (depreciation -) 1/	-1.7	-2.4	-1.1	-4.1	...
Central government (percent of GDP) 2/					
Total revenue, excluding grants and privatization	24.0	24.0	24.4	23.7	23.4
Total expenditure and net lending	27.9	27.8	27.9	27.1	26.2
Central government balance, excl. grants and privatization	-3.9	-3.8	-3.5	-3.5	-2.8
Central government balance, incl. grants, excl. privatization	-3.7	-3.5	-3.1	-3.2	-2.6
Total government debt (foreign and domestic)	60.8	62.8	61.6	60.9	59.2
Money and credit (percent change)					
Credit to the economy	24.2	11.5	6.5	6.2	7.7
Broad money (M3) 3/	14.7	10.3	4.5	6.8	9.3
Velocity of circulation (GDP/M3)	1.882	1.839	1.830	1.849	1.849
Interest rate (money market rate, in percent, e.o.p)	5.88	5.94	5.91	5.00	...
Official reserves					
Gross official reserves (US$ billions, e.o.p)	1.8	2.0	2.3	3.0	3.2
In months of imports of goods & services, c.i.f.	2.4	2.3	2.7	3.0	2.9
Total external debt					
External debt (US$ billions) 4/	11.4	11.6	13.7	16.1	16.2
External debt (in percent of GDP) 4/	58.4	58.1	65.2	64.4	57.4
Debt service ratio (percent of exports of GNFS)	22.6	15.6	17.2	15.1	19.0
Financial market indicators					
Stock market index 5/	1443	1267	1119	1250	1332
Memorandum items:					
GDP at current prices (TD millions)	26,685	28,741	29,890	32,261	35,255
GDP at current prices (US$ billions)	19.5	20.0	21.3	25.0	28.2
GDP per capita (US$)	2,036	2,068	2,181	2,535	2,822
Population (millions)	9.6	9.7	9.8	9.9	10.0
Exchange rate: dinar/US$ (average)	1.37	1.44	1.42	1.29	...

Sources: Tunisian authorities and staff estimates and projections

1/ Information Notice System.
2/ Excludes the social security accounts.
3/ Deposit money banks
4/ Short-term external debt includes nonresidents deposits and excludes commercial debt.
5/ TUNINDEX. (1000 = 4/1/1998). 2004 is for September 10, 2004.

Statement by Abbas Mirakhor, Executive Director for Tunisia
and Sadok Rouai, Senior Advisor to Executive Director
October 27, 2004

Key Points:

- *The Tunisian economy is continuing its recovery from the severe shocks experienced in 2002;*
- *The authorities strive to maintain a stable macroeconomic framework, move gradually toward a floating exchange rate, and liberalize capital movements. They intend to continue working closely with the IMF on macro-relevant issues, and with the World Bank in identifying and prioritizing structural reforms;*
- *Attention will be focused on (i) strengthening the banking sector and reducing NPLs, and (ii) developing a comprehensive fiscal strategy to lower the ratio of public debt to GDP;*
- *Consolidation and modernization of the banking sector and moving toward capital account liberalization are high on the authorities' action plan for the period 2004-09; and*
- *A legislative framework for AML/CFT was introduced, and a Financial Intelligence Unit (FIU) created. The authorities are planning an update to the 2001 FSAP and the 1999 data ROSC.*

Our authorities value their cooperation with the Fund that has contributed to advancing Tunisia's integration into the world economy. They express their gratitude to the Executive Board, management, and staff for their support and advice. They also appreciate the well-balanced staff report and the useful Selected Issues paper, and concur with staff's conclusions and policy recommendations.

The authorities agree that using the lower-tier OECD countries as benchmark helps identify the remaining challenges facing Tunisia and serves as a practical framework for implementation of the cross-country approach under Fund surveillance. Staff's conclusion that Tunisia needs to maintain a per-capita growth differential of 2-4 percent over a decade in order to catch up with Poland and Mexico is a strong reminder to the authorities of the important and multifaceted agenda of reforms that should be implemented. The authorities recognize that short-term achievements, though encouraging, should not divert attention from the importance of sustaining and accelerating reform efforts. In this connection, they recognize three major challenges:

a) Sustained annual growth rate of more than 6 percent to reduce unemployment, especially among young graduates.

b) The banking sector, both public and private, played a pioneering role in the launching of private entrepreneurship in Tunisia, at times with little consideration to soundness. This has contributed to the emergence of a weak credit culture and the build-up of a large stock of

NPLs, as highlighted in the FSAP and the staff paper. While measures for strengthening the banking sector have been taken, much remains to be done to consolidate its financial structure so as to enhance its competitiveness in a more open environment, thus allowing banks to adequately support the private sector's participation in the economy.

c) Tunisia is a country of narrow resource base with a limited domestic market and, therefore, has little choice but to integrate into the global economy. While the authorities are anchoring their economy to the European economy through the Association Agreement with the European Union (AAEU) and the New Neighborhood Policy, they are persuaded that the Maghreb region, as well, offers enormous untapped potential. In this context, they welcome Fund's efforts to assist in strengthening regional integration. To ensure further integration into the global economy, they are committed to the maintenance of a stable macroeconomic framework, to move gradually toward a floating exchange rate, and to liberalize capital account. They intend to maintain close collaboration with the Fund on macro-relevant issues and with the World Bank in identifying and prioritizing structural reforms.

As an indication of the authorities' strong commitment to address these challenges and other priorities, the President's program for the 2004-09 term identifies a number of important reforms and provides a detailed action plan. Consolidation and modernization of the banking sector and the move toward capital account liberalization are high priorities in this program.

I. Policy Focus:

The recovery of the Tunisian economy from the severe shocks experienced in 2002 (the aftermath of the September 11 event and four consecutive years of drought) is well underway, demonstrating that diversification and structural reforms have enhanced the resilience of the economy. It also reflects the authorities' ability to implement macroeconomic policies under changing circumstances while maintaining a medium- to long-term vision for adjustment and reform. In 2004, real GDP growth is expected to remain robust as in 2003 (5.6 percent); the current account and fiscal deficits are to decline to less than 3 percent of GDP; inflation is moderating after the pick-up in 2003 (2.6 percent year-to-year as of end-September 2004) and is expected to return to under 3 percent on average by 2005; the external debt to GDP ratio is expected to decrease by 7 percentage points of GDP in 2004; and unemployment continues to decline. The strength of economic growth is being underpinned by greater flexibility in exchange rate and prudent monetary policies.

As the staff report suggests, the policy discussions focused on: (i) strengthening the banking sector and reducing NPLs; and (ii) developing a comprehensive fiscal strategy to lower the ratio of public debt to GDP.

The authorities share staff's concern regarding the pick-up in NPLs. They agree with staff's conclusion that while their level does not pose systemic risks, it imposes efficiency costs on the economy, contributes to a weakening of the banking sector, and hinders efforts to further liberalize capital movements. During the 2004 Annual Meetings, the Governor of the Central Bank reiterated to staff that reduction of NPLs is a priority not only for the Central Bank but for the political authorities at the highest level. The objective of the Central Bank over the next two fiscal years is to bring down NPLs to their 2001 level, i.e., 19 percent of total outstanding credits, and to increase provisioning substantially. In addition to the actions taken (Box 2 of the staff report), in particular the ban on dividends distribution by banks with insufficient provisions, the implementation of the following measures is underway:

- The minimum delay for writing off a NPL has been reduced from two years to one, and the rules for seizing collateral are being clarified and strengthened;
- Full tax deductibility for provisions will be introduced in the 2005 Budget Law;
- Asset management companies are being established to manage and dispose of hotels seized as collateral for defaulted loans; and
- The Central Bank will play a proactive role in the loan recovery efforts of public banks in a few large transactions. This is expected to send strong signals to both debtors and creditors.

The authorities appreciate FSAP's role in strengthening and prioritizing banking sector reform since 2001, and, as detailed in Box 2 of the staff report, remain committed to implementing staff's recommendations. They agree that an update to FSAP will add momentum to banking sector reforms; the timing of the update will be discussed in the next staff visit.

During discussion with staff, the authorities expressed concern regarding the lack of agreed international norms on the computation of NPLs, classification of bad loans, and provisioning. They believe that regulations in Tunisia are stricter than in other countries, placing the country in a disadvantageous position in cross-country analyses. Nevertheless, they consider their approach as more prudent as it provides a better assessment of strength and weaknesses of the banking sector. They urge the Fund to look into this issue as part of the forthcoming review of the FSAP policy.

Despite the limited fiscal vulnerabilities revealed by the debt sustainability exercise, the authorities concur with staff on the importance of further fiscal consolidation to enhance flexibility in fiscal policy and to support the ongoing reform of the macroeconomic policy framework. The objective is to reduce the public debt-to-GDP ratio to 45 percent by end-2009. To achieve this goal, the authorities are in the process of launching, with FAD technical support, a major reform of tax policy and administration. They expect this reform to improve the private sector environment, strengthen tax collection, and contribute to improved competitiveness of the Tunisian economy.

The requirements of the two priority sectors, health and education, as well as the need to modernize public administration and attract and retain skilled personnel impose constraints on efforts to retrench the wage bill in the immediate period ahead. However, the authorities are confident that the introduction of performance-based budgeting will lead to improved efficiency and increased savings in public expenditures.

The authorities are presently in the process of finalizing the 2005 Budget and note with concerns recent developments in oil markets which have a direct adverse impact on the fiscal position and the balance of payments. In 2004, the authorities have implemented two adjustments in retail prices and have introduced legislation to promote efficient use of energy, including through mandatory audit for large users and encouragement of greater reliance on renewable resources.

II. Effectiveness of Surveillance:

It is worth noting that the recent biennial review of the implementation of the Fund's surveillance suggested that: "*After exiting from an IMF-supported program in 1992, Tunisia has maintained a close and productive policy dialogue with the Fund in the context of surveillance. There seems to be a sense of appreciation for Fund's policy advice as contributing to the authorities' success in achieving high economic growth and financial stability. The authorities have consented to publication of country reports, which helped reinforce investors' positive view on the economy. The Fund's policy advice also seems to have been a useful input into the internal policy debate*."

Between 1986 and 1992, the authorities implemented adjustment and reform programs supported by a SBA and an EFF, which allowed Tunisia to achieve three main objectives: (i) to reestablish and maintain macroeconomic stability; (ii) to implement necessary structural reforms leading to the diversification of the economy and strengthening its resilience to shocks; and (iii) to establish an investment grade rating which allowed access to international capital markets on favorable terms. In this context, Tunisia's participation over the years in Fund's transparency, FSAP, and standards and codes initiatives has helped the attainment of the above objectives, particularly in achieving a favorable perception among investors. The following list is a record of this participation:

- PINs published since June 1997.
- Staff concluding statements published since June 1999 and Article IV staff reports published since September 1999.
- SDDS subscriber since June 2001.
- FSAP and associated ROSC modules completed in 2001-2002 and the FSSA published on June 2002.
- Dissemination by the Central Bank of daily monetary and financial indicators, including international reserves, on its website.
- A press conference is held by staff at the conclusion of every Article IV mission.
- A press communiqué is issued following the monthly meeting of the Board of the Central Bank.

In 1992, toward the end of the Fund-supported EFF, the authorities took two major operational decisions regarding future relations with the Fund. First, they aligned the macroeconomic framework underlying their Five-Year Development Plans with staff's medium-term projections. This process is still continuing during the design stage of each Plan which helps to instill transparency and consistency in economic policy. Second, they opted for regular staff visits between consultations. These visits receive the same degree of attention as the regular Article IV consultation and culminate in the publication of staff's concluding statement. These visits produce an agreed framework of a monetary program for the following year with quarterly indicative targets. These visits allow close coordination on the content and coverage of the next Article IV consultation and agreement on the selected issues to be prepared by staff to support specific policy conclusions and/or recommendations. The following is a list of such papers prepared in recent years:

- Real exchange rate targeting—Tunisia's experience (May 2001).
- Liberalization of the capital accounts—Progress achieved and prospects for full convertibility (May 2002).
- Strengthening the monetary framework and instruments (July 2003).
- Assessing reserves adequacy in Tunisia (October 2004).
- Is Tunisia trading to its potential (October 2004).
- How does employment protection legislation affect unemployment (October 2004).

The authorities and staff have been successful in placing the Tunisia-Fund relations within a multi-year work program involving a limited number of policy priorities. It is worth noting that the 2004 biennial review of Fund surveillance has acknowledged the effectiveness of such an approach. The current multi-year work program was developed in 2002 as a by-product of the FSAP exercise. It focuses on the strategy to achieve capital account convertibility and builds on the operational approach considered by the Board in 2001.[1] This strategy has allowed the authorities to: (i) confirm the absence of exchange rate misalignment and gradually move away from targeting the REER; (ii) define the sequencing of capital account liberalization; (iii) develop a monetary policy framework; (iv) assess the adequacy of international reserves; and (v) advance banking sector reforms. Tunisia's gradual strategy to liberalizing capital movements will be assessed by the IEO as part of the forthcoming evaluation of the IMF's approach to capital account liberalization.

We conclude by reiterating that, as before, the authorities look forward to Board discussion of this year's staff report and value immensely Directors' views, guidance, and support.

[1] Capital account liberalization and financial sector stability; considerations for sequencing and policies issues (SM/01/186, Sup.1, and Sup. 2).