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Tunisia: 2002 Article IV Consultation—Staff Report and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2002 Article IV consultation with Tunisia, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **March 11, 2002,** 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 May 16, 2002.** 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 June 5, 2002 discussion** of the staff report that concluded the Article IV consultation.

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

Selected Issues Paper,
Report on the Observance of Standards and Codes,
and Financial System Stability Assessment Paper.

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

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INTERNATIONAL MONETARY FUND

TUNISIA

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives for the 2002 Consultation with Tunisia

Approved by Paul Chabrier and Masood Ahmed

May 16, 2002

- Discussions for the 2002 Article IV consultation were held in Tunis during February 26-March 11, 2002. The staff team included Mr. Fanizza (head), Ms. Laframboise, Mr. Martin, Ms. Sab, and Ms. Karpowicz (all MED). Messrs. Laurens and Sarr (both MAE) also joined the mission to review FSAP recommendations and issues related to capital account liberalization. The mission coordinated in the field with World Bank staff discussing progress related to the FSAP and ongoing adjustment lending.

- The mission met with Governor Daouas (Central Bank of Tunisia), Minister Baccar (Finance), Minister Saddam (Economic Development), Minister Sioud (Commerce), Minister Rabah (Agriculture), Minister Nabli (Environment), Minister Zeneidi (Tourism). The staff also met with the main trade union, representatives of the commerce/industry association, and with representatives of the banking and financial sector. Mr. Rouai, Advisor to the Executive Director, attended most of the meetings.

- At the conclusion of the last Article IV consultation on February 5, 2001, Executive Directors commended the authorities for maintaining macroeconomic stability as a prerequisite for growth and investment, and for containing rising pressures on the external accounts. In this context, they encouraged the authorities to keep the fiscal deficit on a downward path while improving the structure of the budget. Directors stressed that structural reforms and liberalization of trade and prices held the key to moving the economy to a higher growth path and to lowering unemployment.

- The authorities have continued to increase the transparency of their policies: Tunisia subscribed to the Special Data Dissemination Standard (SDDS) in June, 2001, published the 2000 Article IV Staff Report, and published both the Preliminary Conclusions of the 2002 Article IV mission and the Observations of the Interim Consultation Mission. The authorities intend to publish the 2002 Article IV Staff Report, and the FSSA.

- Tunisia accepted the obligations of Article VIII, Sections 2-4 in January 1993.

- The principal authors of this report are Mr. Domenico Fanizza and Ms. Nicole Laframboise.

Contents

Tables

Attachment

Appendices

GLOSSARY

AAEU	Association Agreement with the European Union
AML	Anti-Money Laundering
BAD	*Banque Africaine de Développement*
CFT	Combating the Financing of Terrorism
CNRPS	*Caisse Nationale de Retraite et Prévoyance Sociale*
CNSS	*Caisse Nationale de Sécurité Sociale*
CPI	Consumer price index
CSS	*Caisses de Sécurité Sociale*
DSBB	Dissemination Standards Bulletin Board
ECAL	Economic Competitiveness Adjustment Loan
EFF	Extended Fund Facility
EU	European Union
FSAP	Financial Sector Assessment Program
FSSA	Financial Sector Stability Assessment
IBRD	International Bank for Reconstruction and Development
IDA	International Development Agency
IFS	*International Finance Statistics*
IMF	International Monetary Fund
MFN	Most-favored nation
NPL	Nonperforming loan
PIN	Press Information Notice
SDDS	Special Data Dissemination Standard
SICAV	*Société d'Investissement à Capital Variable*
TMM	*Taux du marché monétaire*
VAT	Value-added tax

EXECUTIVE SUMMARY

- Tunisia's successful economic performance reflects the gradual liberalization of the economy, which has resulted in strong gains in terms of productivity, growth, and economic diversification. Growth has been strong in all sectors, with the exception of agriculture, which has experienced drought conditions for the last three years.

- The authorities now face the challenge of reining in strong demand, which has put pressures on the external position and lowered foreign exchange reserves. Despite an impressive export performance, the external current account deficit remained unchanged at 4.2 percent of GDP in 2001, while drawings from international capital markets and from the World Bank helped to maintain external reserve coverage at 2.5 months of imports.

- Fiscal policy maintained a broadly neutral stance in 2001. The central bank tightened its monetary stance in response to the deteriorating external position and the expansion of liquidity aggregates during the year. Consumer price inflation remained subdued.

- The past years of robust economic growth are likely to be cut short by the impact of the events of September 11, 2001 on tourism flows, and by a further drop in agricultural production as a result of continued drought. These two factors are likely to weigh on the external position and could push the external current account deficit above 5 percent of GDP in 2002 if macroeconomic policies are not adjusted.

- The authorities and the staff agreed that fiscal and monetary policies should be tightened to limit the widening of the current account deficit to 4.5 percent of GDP. This will help to raise the external reserve coverage to 3 months of imports. The authorities are targeting a fiscal deficit reduction of 0.7 percent of GDP and a substantial deceleration in liquidity aggregates in 2002. Indicators of external competitiveness suggest that, in the short term, the authorities should continue to follow their pragmatic exchange rate policy.

- The authorities intend to gradually liberalize the external capital account to sustain a higher growth path over the medium term. Since this would modify substantially the environment for macroeconomic policies, the following conditions need to be satisfied before taking substantial steps in this direction: the establishment of a transparent and solid framework for monetary policy; establishment of a floating exchange rate regime; further progress in strengthening the banking system; and progress in addressing budget rigidities.

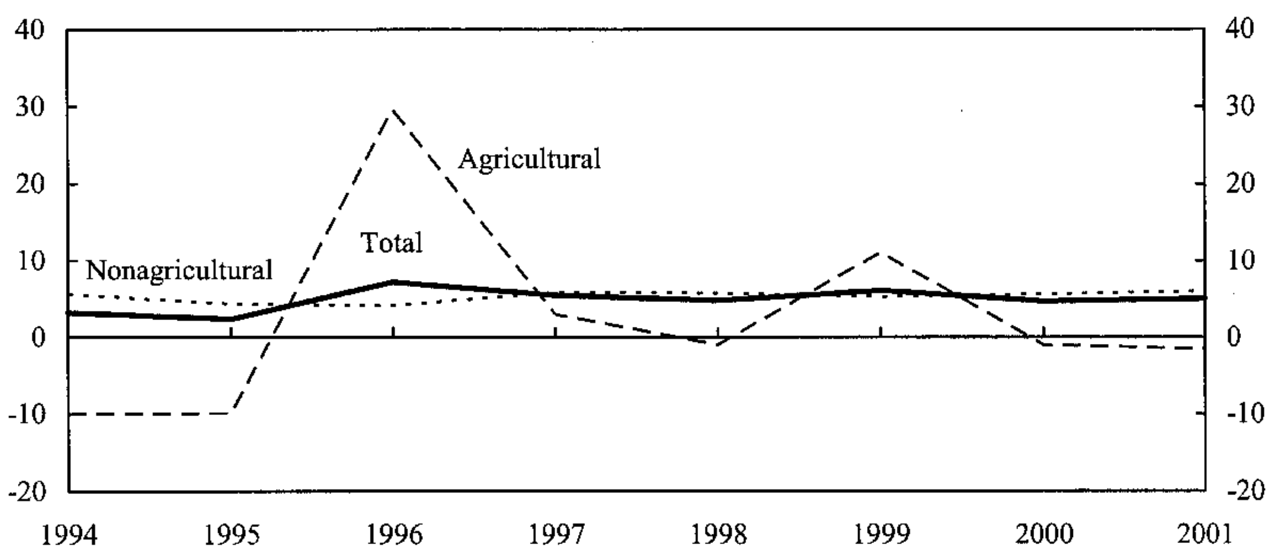
- The overriding policy objective is to lower unemployment over the medium term. This requires an intensification of structural reform and further progress in fiscal consolidation. Priority areas for structural reform are price liberalization, most-favored nation (MFN) tariff reduction, and civil service reform. Moreover, the authorities should continue their ongoing efforts to strengthen the financial system, improve the private investment climate, and push forward with privatization, as envisaged under the World Bank Economic Competiveness Adjustment Loan (ECAL III).

I. Background

1. **Economic growth averaged 5.5 percent during the period 1996-2001** (Figure 1). Gradual liberalization of the economy has thus far produced results in terms of productivity, growth, and economic diversification. GDP growth has been strong in all sectors, with the exception of agriculture, which has experienced drought conditions for the last three years. Private sector activity has risen in the export and tourism sectors, while domestic demand has been buoyed by rising real incomes. Investment in the services and export-oriented manufacturing sectors has been particularly strong (Figure 2).

2. **Tunisia's successful economic performance reflects well-coordinated macroeconomic, structural, and social policies.** Price stability has been maintained by prudent monetary policy backed by an active income policy, while fiscal policy has been oriented toward consolidation since the mid-1990s. To promote competitiveness and export-driven growth, the authorities followed a policy of targeting a constant real exchange rate while generally restricting capital mobility. Social policies have contributed to reducing poverty incidence from 13 percent in 1980 to 4 percent in 2000. The Association Agreement with the European Union (AAEU)[1] has served as an impetus to comprehensive reform. In addition, the authorities strengthened banking sector soundness in the late 1990s and have pursued a steady, if at times hesitant, opening and liberalization of the economy. Very recently, the second cellular telephone license (GSM) was sold for US$454 million to an Egyptian company.

Figure 1. Tunisia: Real GDP, 1994-2001
(Percent change)



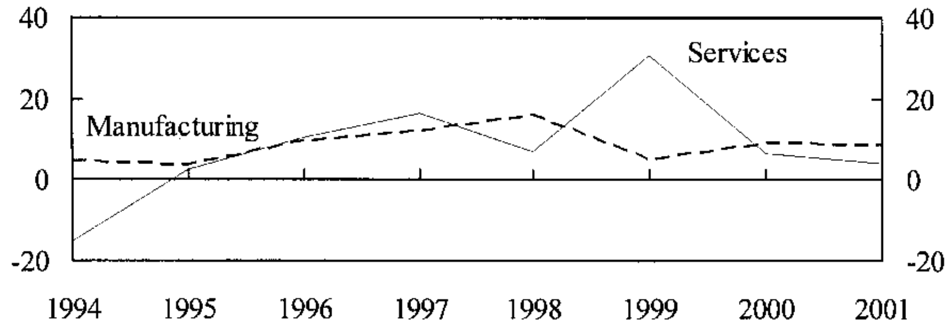
Source: Tunisian authorities.

[1] The AAEU, which was signed in 1995, aims to increase openness by harmonizing legislation and regulations with those of the European Union (EU). Tunisia will achieve reciprocal free trade in manufactured goods by 2008, attain preferential and reciprocal access for agricultural goods, and liberalize foreign direct investment flows and trade in services. In addition, the Agreement includes provisions covering information exchange, consulting services, and assistance with technical, regulatory, and administrative matters.

Figure 2. Tunisia: Gross Fixed Capital Formation,

1994-2001

(Percent change)



3. **Despite relatively robust growth rates and an active private sector, further work is required to advance the reform agenda.** Trade protection remains high, even with the trade liberalization under the AAEU, because of high MFN tariffs; the state retains control over a significant part of the economy; financial sector vulnerabilities persist, despite considerable progress; and unemployment remains at around 15 percent, despite significant job creation over the past five years.

4. **President Ben Ali announced plans to hold a national referendum on May 26, 2002** on a proposal to modify the constitution to foster greater political opening and strengthen human rights. The referendum proposal will also amend the constitutional clause that prohibits Mr. Ben Ali's reelection in 2004.[2]

5. Tunisia has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. Tunisia maintains a multiple currency practice resulting from honoring the exchange rate guarantees extended prior to August 1998 to development banks, which will expire after the existing commitments under the guarantee scheme have been paid.

II. Recent Economic and Policy Developments

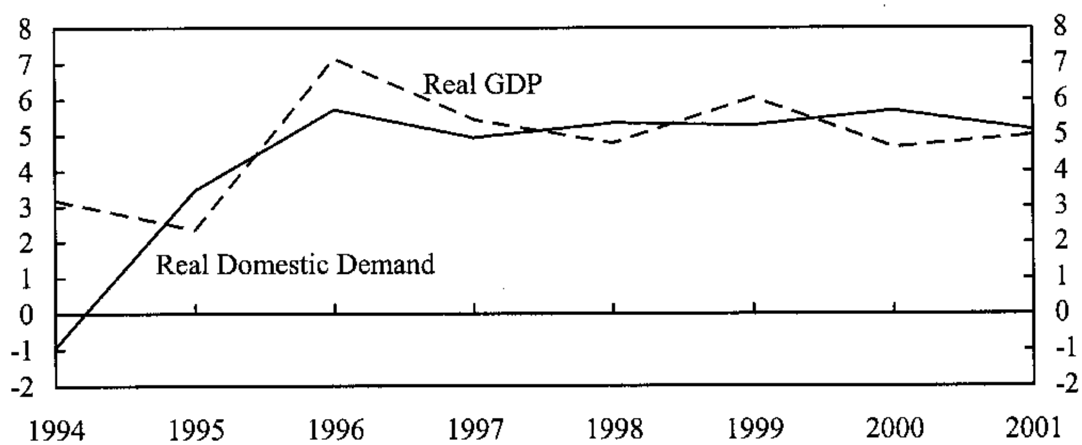
6. **Real GDP grew by 5 percent in 2001 compared to 4.7 percent in 2000**, despite a contraction in agricultural output of 1.5 percent caused by continued drought. Manufacturing growth remained strong: activity was particularly robust in the mechanical-electrical industry, which grew by 14 percent, and the textile industry, which expanded by 12 percent. The services sector also moved ahead in 2001, growing by an estimated 6.3 percent. While exports continued to be an engine of growth, domestic demand grew at 5.2 percent. Unemployment has remained high, although the unemployment rate declined to 15 percent in 2001 from a high of 15.9 percent in 1998.

7. **The authorities now face the challenge of reining in strong demand, which has put pressure on the external balance and lowered foreign exchange reserves.** With domestic demand growth outpacing GDP growth, Tunisia's savings-investment gap did not

[2] Under the constitution, a president cannot be reelected more than two times and the maximum age of a presidential candidate is 65. These limits were introduced by Mr. Ben Ali after he seized power in 1987. Since then, he has been elected to office twice.

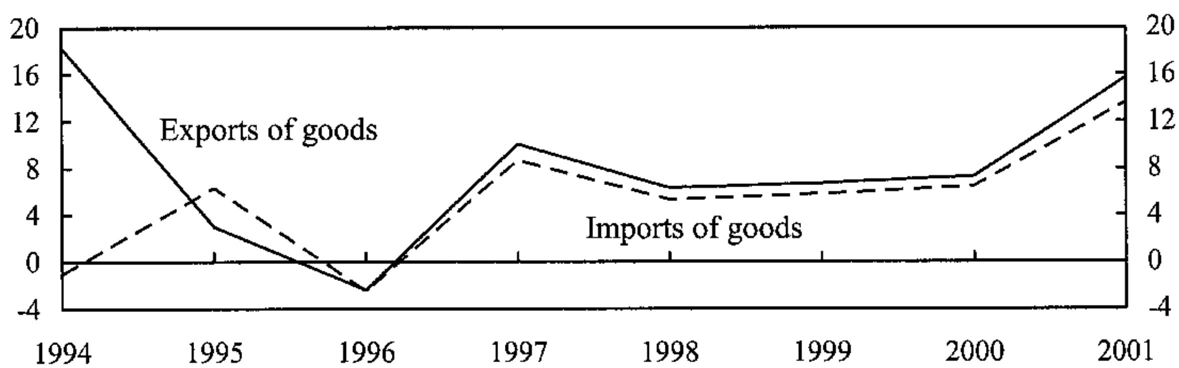
improve in 2001, despite impressive real export growth of 16 percent and improved tourism receipts (Figures 3 and 4).[3] The export performance confirms gains in the competitiveness of Tunisian producers, particularly in the mechanical, electrical, and textile sectors.[4]

Figure 3. Tunisia: Real GDP and Domestic Demand, 1994-2001
(Percent change)



Source: Tunisian authorities.

Figure 4. Tunisia: Trade Volumes, 1994-2001
(Percent change)



Source: Tunisian authorities.

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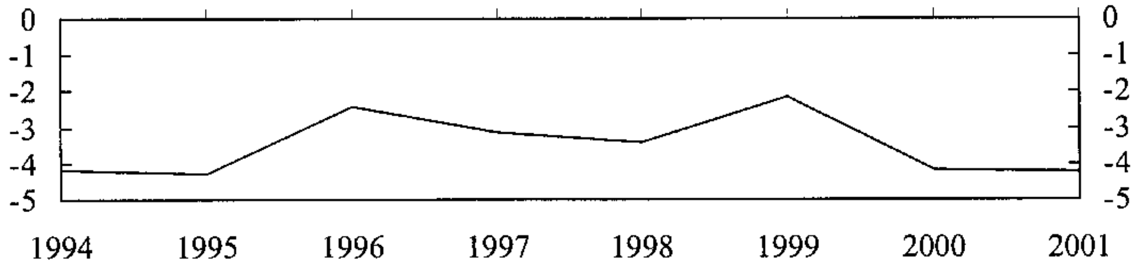
[3] Real export growth was led by the mechanic, electrical, and textile sectors, which increased by 28 percent and 20 percent, respectively.

[4] In addition, 340 new exporters were established in these sectors during the year.

8. **However, import growth was almost as vibrant as export growth**, increasing by 14 percent in volume terms and widening the external trade deficit from 11.5 percent of GDP in 2000 to 11.8 percent of GDP in 2001.[5] The tourism sector performed well, notwithstanding a sharp drop in the fourth quarter; receipts increased by 6 percent in dollar terms. As a result, the external current account deficit remained unchanged at 4.2 percent of GDP in 2001 (Figure 5). The relatively large current account deficit reflects both higher imports related to tariff reduction and strong growth of investment financed by private credit expansion.

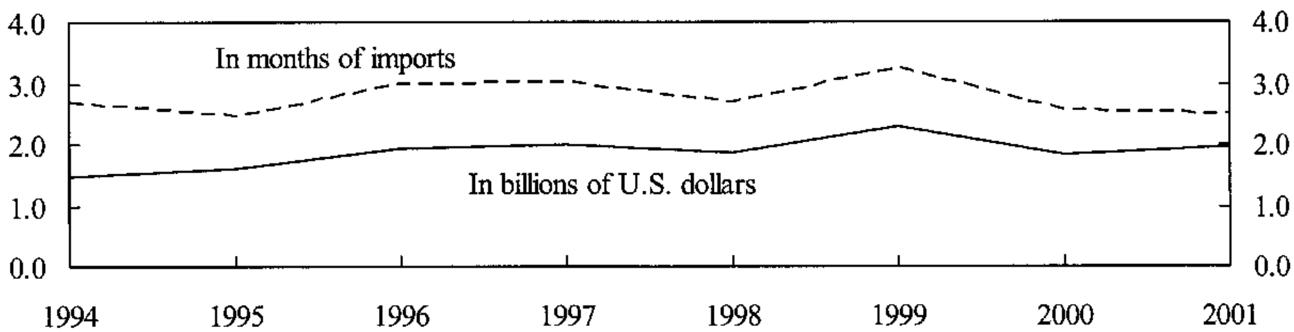
Figure 5. Tunisia: Current Account Balance, 1994-2001
(In percent of GDP)



Source: Tunisian authorities.

9. **External reserve coverage fell to an average level of 2.2 months worth of imports (US$1.7 billion) during the year**, although the first disbursement (US$225 million) of the World Bank's ECAL III in December helped raise foreign exchange reserves to US$2 billion at year-end (2.5 months worth of imports), broadly unchanged from end-2000 (Figure 6). The external current account deficit was financed mostly by stepped-up government borrowing in 2001.

Figure 6. Tunisia: Gross Official Foreign Exchange Reserves, 1994-2001
(End of period)



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

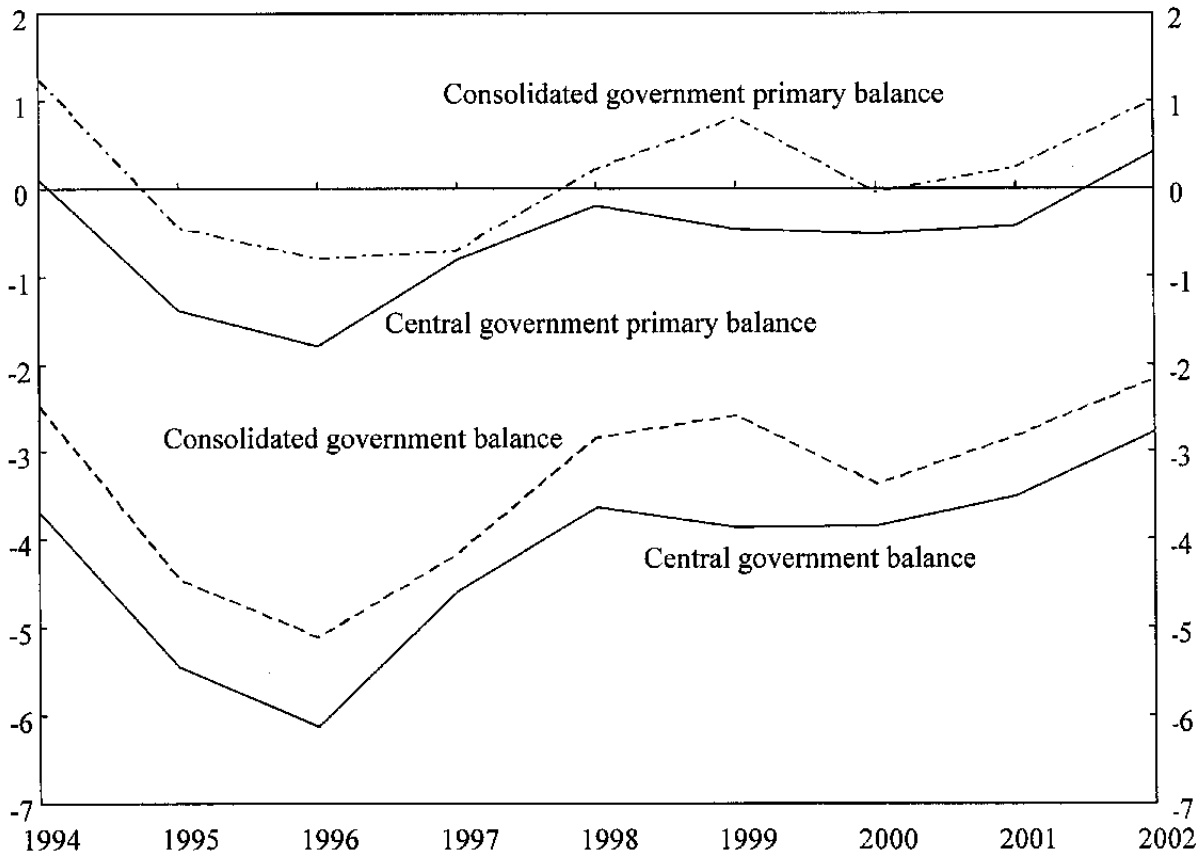
10. **Overall, the fiscal policy stance contributed only marginally to contain demand pressures in 2001.** The deficit of the central government (excluding grants and privatization receipts) was 3.5 percent of GDP, close to the budget target for 2001 (Figure 7). This represents a decline of about 0.3 percentage points of GDP over 2000. Tax revenues, which

[5] The authorities estimate that 63 percent of imports of manufactured and semi-finished goods are destined for re-export.

were 0.4 percent of GDP higher than in 2000, were boosted by strong economic activity, the boom in imports, and improved collection performance. Overall expenditures were higher than expected because of larger-than-projected on-lending of foreign loans, which also implied higher matching domestic funding of investment projects.

Figure 7. Tunisia: Government Budget Balances, 1994-2002 1/

(In percent of GDP)

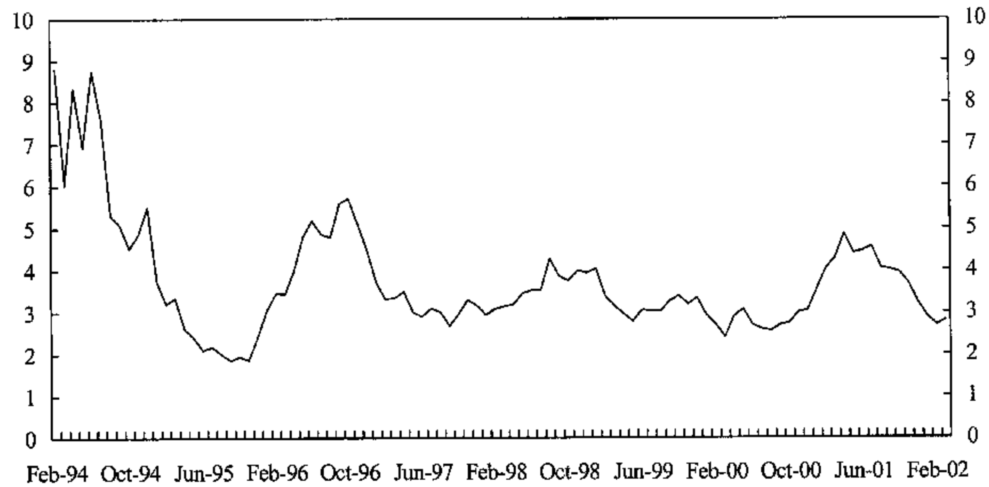


Source: Tunisian authorities.
1/ Excluding grants and privatization.

11. **The authorities tightened their monetary stance during the year in response to the deteriorating external position and the expansion in liquidity aggregates above expectations.** The central bank squeezed liquidity conditions by cutting its refinancing to commercial banks. This drove the money market interest rate (TMM) well above the weekly credit auction rate during 2001 (Figures 8 and 9). As a result, monetary aggregates decelerated significantly during the second half of 2001. Nevertheless, broad liquidity (M4) for the year grew somewhat faster than projected: M4 increased by 6.5 percent compared to a target of 5.5 percent, while broad money (M3) grew by 11.4 percent compared with a target of 9.1 percent (Figure 10). Significant repayments of domestic government debt created scope for a large expansion in credit to the private sector, which rose by more than 10 percent from 8 percent in 2000 (Figure 11). This fueled strong economic activity and raised imports, but produced little effect on domestic inflation.

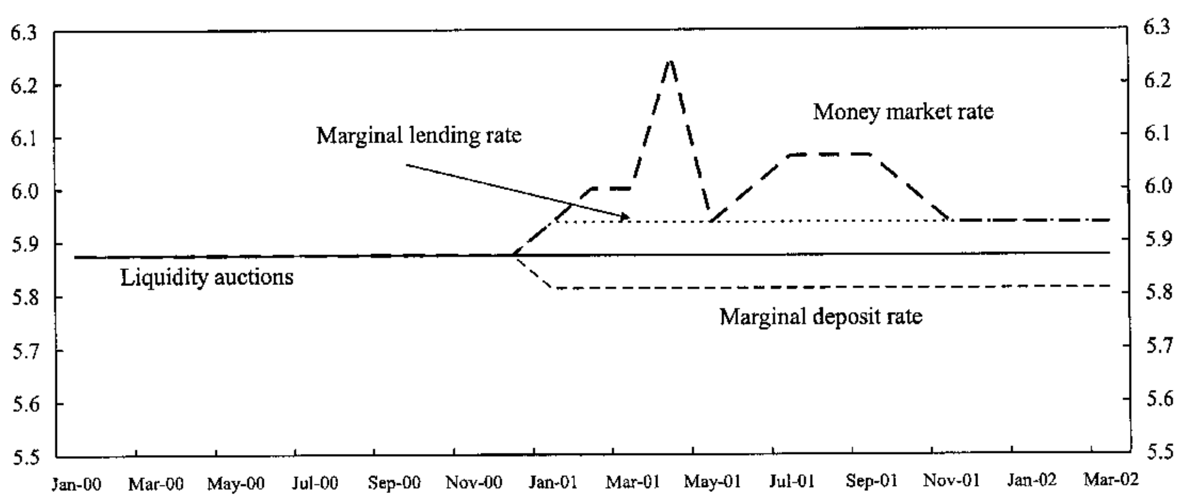
Figure 8. Tunisia: Real Interest Rate, 1994-2002 1/

(In percent)



Source: Data provided by the Tunisian authorities and Fund staff estimates.
1/ Overnight money market rate of the current period deflated by the next period CPI inflation.

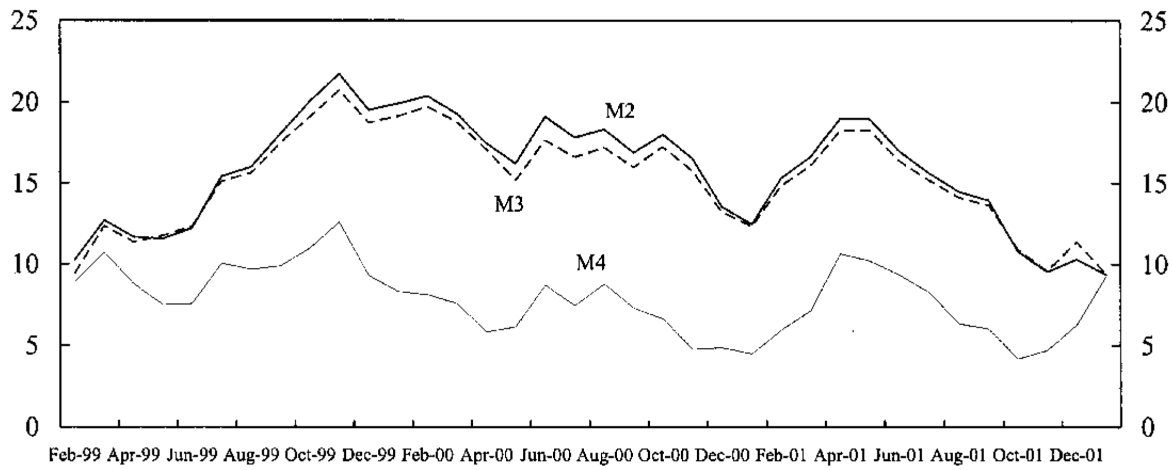
Figure 9. Tunisia: Interest Rates, 2000-02
(In percent)



Source: Tunisian authorities.

Figure 10. Tunisia: Monetary Aggregates, 1999-2001

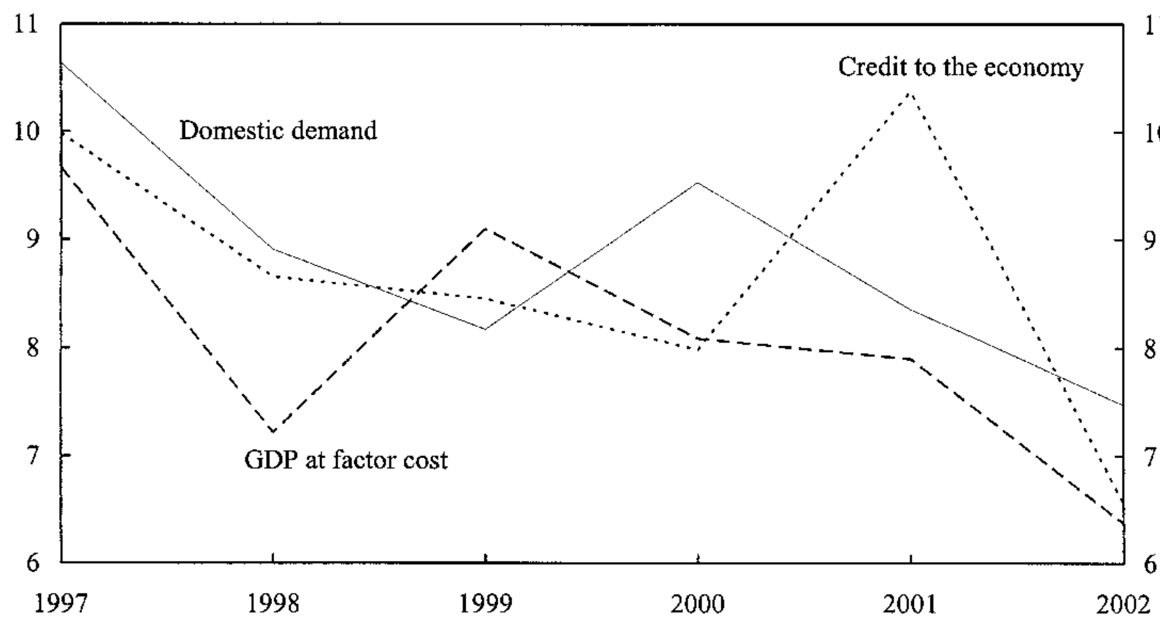
(Year on year percent change)



Source: Tunisian authorities.

Figure 11. Tunisia: Credit to the Economy, 1997-2002

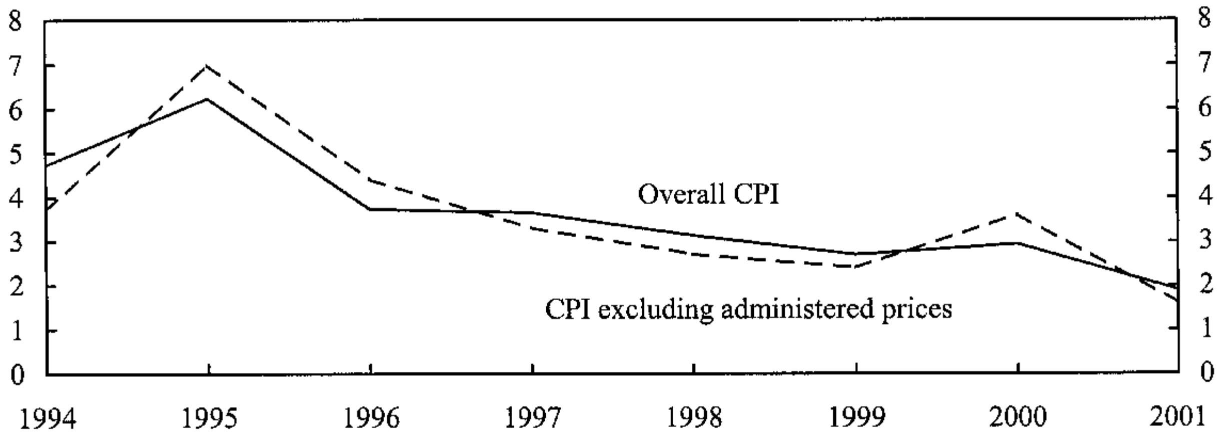
(In percent change)



Source: Tunisian authorities.

12. **Consumer price index (CPI) inflation dropped in 2001 to 1.9 percent, its lowest rate since 1972** (Figure 12). Price pressures were subdued during the year for a number of reasons: (a) much of the increase in private sector credit flowed into higher imports, thereby reducing price pressures on domestic goods; (b) administered prices, which still represent one third of the CPI, were raised only slightly and domestic petroleum prices were not raised during the year; and (c) the reduction in tariffs on manufactured goods helped keep prices down.

Figure 12. Tunisia: Consumer Price Index, 1994-2001
(Percent change)



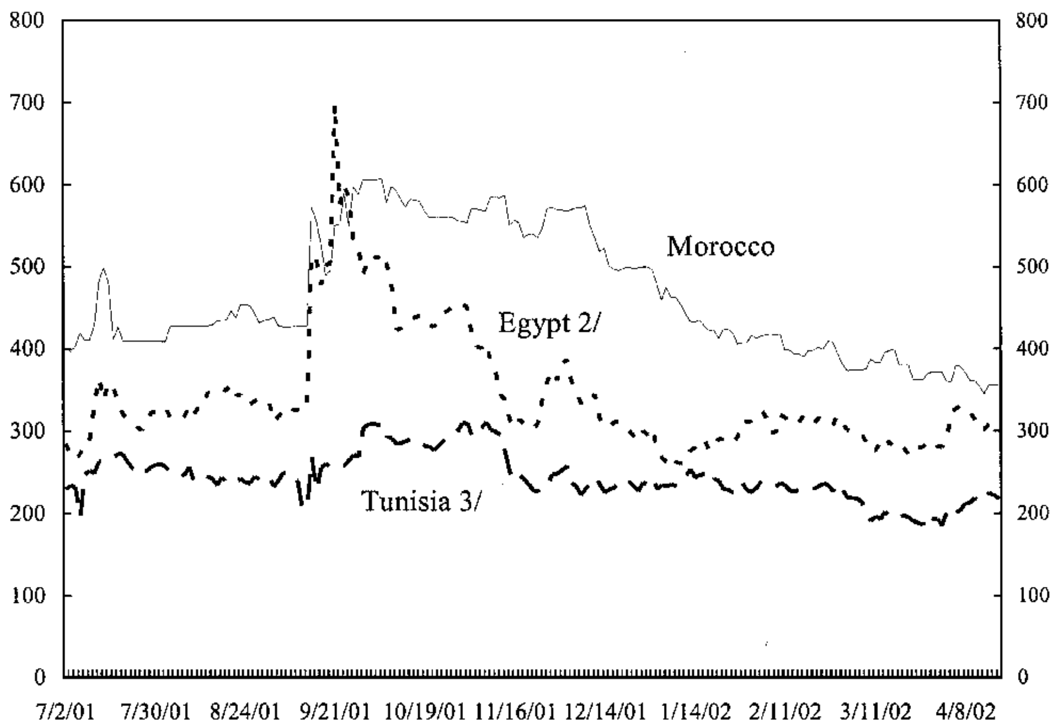
Source: Tunisian authorities.

13. **In addition to tighter monetary policy, the authorities followed a more flexible approach to exchange rate policy.** The average real effective exchange rate depreciated by 0.6 percent in 2000 and by 2.5 percent in 2001. In nominal terms, the weakness in the euro over the last three years has led to a fall in the value of the dinar relative to the U.S. dollar of 25 percent.

14. **The authorities drew again on international capital markets to help finance the current account deficit.**[6] After increasing significantly less than for other emerging markets, spreads on secondary market debt have now returned to the levels prevailing before September 11 (Figure 13). Standard and Poor's reconfirmed its BBB rating on Tunisian foreign currency long-term sovereign credit, and in May 2001, Fitch upgraded Tunisia's foreign currency debt rating from BBB- to BBB.

[6] In March 2001, the authorities issued two yen-denominated bonds totaling US$460 million with spreads of 163 basis points over yen-Libor (5-year Samurai) and 207 basis points over yen-Libor (30-year global yen bond).

Figure 13. Secondary Market Spreads on Government Bonds, 2001-02 1/



Source: Merril Lynch.
1/ Loan tranch A for Morocco, Eurobonds for Tunisia and Egypt.
2/ Average spread of two Eurobonds with 4 years and 9 years remaining maturities.
3/ Average spread of two Eurobonds with 5 years and 10 years remaing maturities.

15. **Tunisia's external vulnerability moderated somewhat in 2001, but needs to be monitored closely** as debt ratios remain quite high. Short-term debt (by residual maturity) as a share of foreign reserves, having risen to 160 percent from 110 percent in 1999, declined to an estimated 126 percent at end-2001.[7] With amortization flows down from their repayment hump in 2000, external debt service as a share of exports of goods and nonfactor services declined substantially to 15.6 percent from 22.6 percent in 2000. Due to higher net borrowing, however, total external debt rose slightly to 60.2 percent of GDP from 59.6 percent of GDP in 2000.

16. **Progress in structural reform was concentrated in the telecommunications and financial sectors**. The authorities' efforts at liberalizing the telecommunications sector culminated in the successful sale of the second GSM license in March 2002, originally scheduled for 2001. Moreover, headway was made in strengthening the financial sector and

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[7] Tunisia made an early repurchase of SDR 22 million in May 2001, the balance outstanding under the 1988 Extended Fund Facility (EFF).

reorganizing the insurance sector. Tariff reduction under the AAEU moved ahead broadly as scheduled. In addition, Tunisia's simple average tariff rate declined from 35.9 percent in 2000 to 28.3 percent in 2001. However, Tunisia's rating under the IMF's trade restrictiveness index remains high at 8 (where 10 is the most restrictive), namely as a result of high top marginal tariff rates, a large number of rates, and nontariff barriers, which continue to protect domestic markets.

III. Prospects for 2002 and Macroeconomic Policy Discussions

17. Sustaining Tunisia's favorable growth performance requires, on the one hand, preserving macroeconomic stability with a tightening of the fiscal and monetary stance in response to shocks that are weighing on the external position. On the other hand, it also requires further substantial efforts at opening and liberalizing the economy, and pushing through market-oriented institutional reforms. Thus, the macroeconomic policy discussion focused on the following three key issues: (a) the short-term prospects for the Tunisian economy and the policy challenges; (b) the medium-term implications for monetary and exchange rate policies in view of the authorities' desire to further liberalize the economy and gradually open the external capital account; and (c) the medium-term outlook and risks.

A. Outlook for 2002 and Challenges for Macroeconomic Policies

18. **The past two years of robust economic expansion are likely to be cut short** by the impact of the events of September 11, 2001 on tourism flows, which are projected to drop by 9 percent, and by a 5 percent drop in agricultural production in 2002. Thus, real GDP growth is forecast to fall below 4 percent in 2002. These two factors are likely to weigh on the country's external position by about TD 530 million (or 1.7 percent of GDP), and could raise the external current account deficit to above 5 percent of GDP if macroeconomic policies are kept unchanged from 2001.[8]

19. Despite considerable recent private investment and the creation of many new exporting firms, **supply constraints make it unlikely that export growth could continue at the pace registered in 2000-01**. In this regard, import growth would also drop because of its close link with export activity. The authorities believed that a significant component of the deterioration in the outlook for the external current account reflects temporary factors that are likely to be reversed. Moreover, they viewed the surge in private investments—the source of the structural component of this deterioration—as a positive factor.

20. The staff believed that the authorities' projections were appropriately cautious, particularly given the large projected decline in tourism receipts. **The staff felt, however, that the deterioration in the external position could not be ignored.** For two years in a row, domestic demand has outpaced domestic production. Moreover, higher investment

[8] The drop in tourism flows is projected to have an impact of 1.2 percentage points of GDP.

explains only part of the growth in domestic demand.[9] If this trend were to continue, macroeconomic stability—the foundation of Tunisia's strong economic performance—would be in danger. The worsening in the international outlook makes restraining demand growth in line with domestic resource growth an imperative in 2002. In particular, policies should aim at ensuring the attainment of an external reserve target equivalent to three months of imports without increasing external debt, which, at about 60 percent of GDP, remains high. A tightening in monetary and fiscal policies would limit the increase in the external current account deficit and help to improve other indicators of external vulnerability, such as short-term debt as a share of external reserves.

21. The staff took the position that **the burden of the policy adjustment should be shared by fiscal and monetary policies**. The authorities should continue to follow their more flexible approach to exchange rate policy, which appears appropriate as indicators point to competitiveness gains and improvements in productivity.

Fiscal and Monetary Policy Stance

22. **The staff and authorities shared the view that a reduction in the central government deficit of 0.7 percentage points of GDP (excluding grants and privatization) would be appropriate in 2002.** However, the staff pointed out that the budget law implied little adjustment in 2002. In fact, the deficit target of 2.7 percent of GDP (excluding grants and privatization proceeds) is based on a reduction in government net-lending of ½ of a percentage point of GDP. This reflects the conventional assumption in budget preparation of no on-lending operations. Since government on-lending in 2002 is likely to be close to its recent annual average of about 0.5 percent of GDP (Figure 14), the staff argued that additional expenditure savings in non-lending related outlays of 0.5 percent of GDP were needed to obtain the targeted reduction in the fiscal deficit and to reduce domestic absorption by enough to affect the external position. The authorities indicated that they had identified areas for possible expenditure savings, which they stand ready to implement if a deterioration in the external position, particularly in the tourism sector, materializes during the course of the year. These measures include: (a) restricting spending units to rely only on their budgetary allocation without accessing unallocated budgetary funds (TD 185 million);[10] and (b) postponing a number of new investment projects. Moreover, they indicated that they intend to take additional measures to ensure the attainment of budget targets in the event the economy-wide triennial wage negotiation round (scheduled for July 2002) results in a higher-than-projected wage bill.

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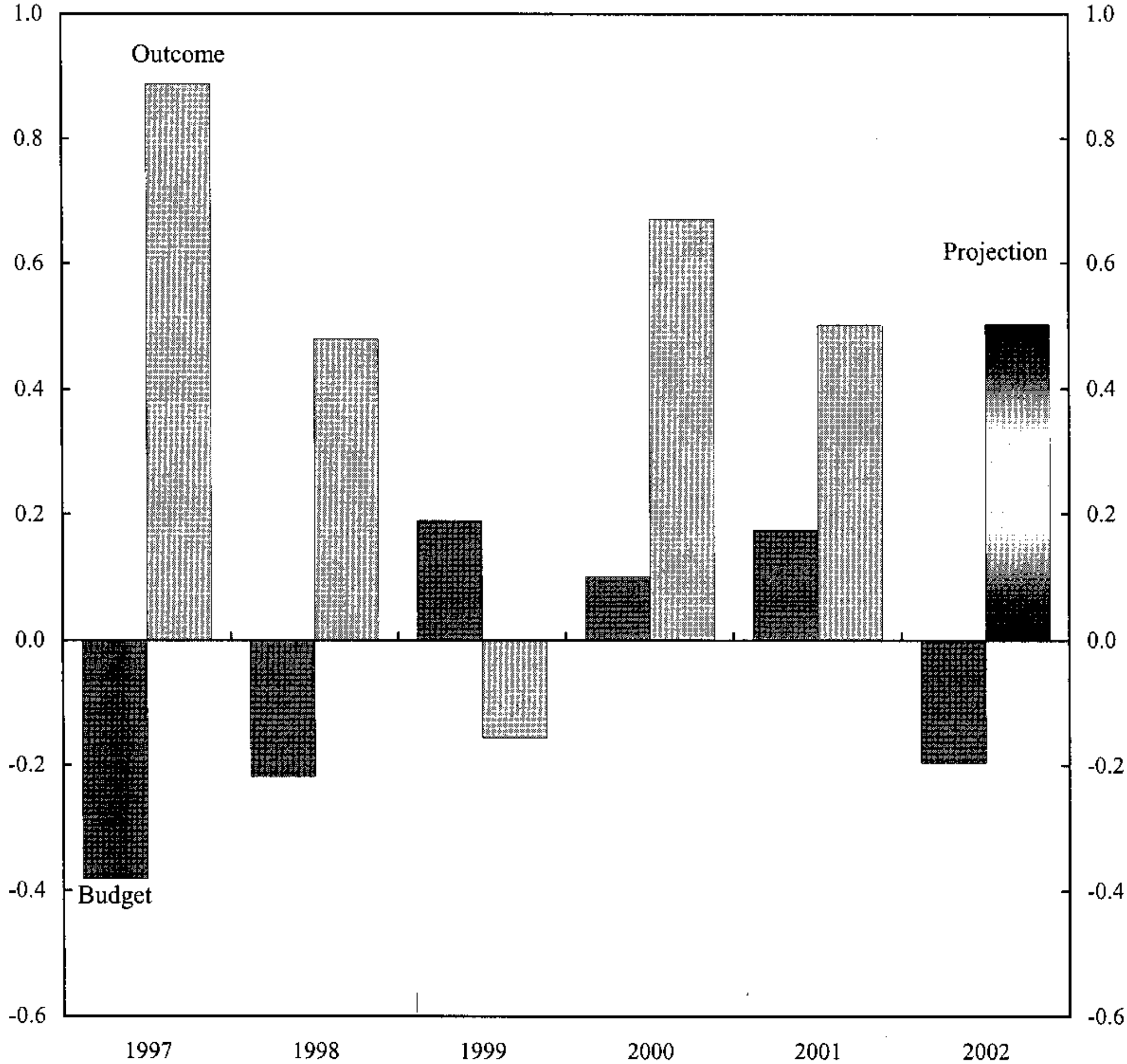
[9] While gross capital formation increased by 7 percent and 5 percent in 2000 and 2001, both private and public consumption growth surpassed 5 percent in 2000 and 2001, exceeding slightly real GDP growth.

[10] This buffer amount was included in the 2002 budget law to finance outlays in response to unexpected events and emergencies.

Figure 14. Tunisia: Net Lending Operations of the Consolidated Government, 1997-2002

(In percent of GDP)



Source: Tunisian authorities.

23. **The central bank's monetary program envisions a substantial tightening in monetary conditions in 2002**. The target growth rate for broad money is 7 percent, 3 percentage points lower than in 2001. Given an external reserve coverage target of 3 months of imports and significant repayment of domestic government debt, this program would translate into a deceleration in credit to the economy after the acceleration which fueled the surge in imports in 2001. This tightening will be sufficient to curb the expansion in domestic demand, as long as it is complemented by action on the fiscal front. In the absence of a reduction in the fiscal deficit, monetary policy will have to bear the burden of

further adjustment in 2002. This will result in an increase in the interbank money market interest rate (TMM), which could crowd out private sector activity and constrain growth prospects.[11] Fiscal adjustment would help to reduce demand pressures and limit the expected increase in inflation in 2002, which is forecast at 3.4 percent due to an adjustment in administered prices and the delayed impact of demand pressures.

Exchange rate policy

24. The authorities explained that their apparent departure from the fixed real exchange rule over the past 18 months reflects more the use of a broader range of indicators to gauge the competitive position of Tunisian producers (e.g. developments in export market shares), than an attempt to offset the impact of the tariff reduction in the context of the AAEU. In fact, they believed that CPI-based measures of the real effective exchange rate (REER) could provide a biased estimate of external competitiveness because of the large component of administered prices.

25. **The authorities and the mission shared the view that exchange rate depreciation could not be used as a substitute for the fiscal and monetary adjustments** required to bring domestic demand under control and manage pressures on the relative price of traded to nontraded goods. Based on staff estimates of competitiveness (see Selected Issues Paper SM/02/155, Chapter I), the strong export performance and significant productivity improvements suggest that the recent broadening of the current account balance does not reflect a misalignment of the exchange rate.

26. The CPI-based REER appreciated by only 2 percent between 1990 and 2001. Competitiveness indices based on prices and unit labor costs show that Tunisia is maintaining competitiveness relative to key partners. Labor productivity in manufacturing grew by 2.2 percent annually in the late 1990s. The relative price of nontraded to traded goods has decreased and Tunisia has increased its market share in the EU. **Thus, the authorities and the mission agreed that there was no reason to modify their current pragmatic approach to exchange rate policy, but that fiscal and monetary tightening were needed to address the external imbalance**.

27. Under the staff's proposed policy scenario, the current account deficit would still widen to 4.5 percent of GDP in 2002 because of the adverse impact of drought and slower tourism growth. However, the external reserve target could be attained comfortably thanks to the capital inflows linked to the recent sale of the second GSM license, the large April 2002 bond issue on international capital markets, and the remaining disbursements of the World Bank ECAL III loan.[12] **External vulnerability indicators would either improve or remain unchanged** (Table 7). External debt as a share of GDP would remain broadly unchanged because part of the current account deficit will be financed by nondebt

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[11] Almost all loans are indexed to the TMM.

[12] The authorities issued a 10-year bond for US$650 million with a spread of 235 basis points over US treasuries.

flows linked to the GSM license sale. The ratio of short-term debt (including amortization payments) as a share of reserves would decline to 115 percent from 126 percent in 2001.

B. A New Framework for Monetary and Exchange Rate Policies

28. **Tunisia's move to increased economic openness and liberalization in the context of the AAEU calls for a reexamination of the conduct of macroeconomic policies.** Moreover, the authorities indicated their intention to proceed with a gradual liberalization of external capital flows to allow Tunisia to sustain a higher growth path over the medium term by tapping foreign savings, financing increased investment needs, and strengthening the efficiency of the domestic financial system. Thus, the mission reviewed the overall macroeconomic policy mix and the overall institutional preparedness to face these challenges. The central bank has already taken significant steps to give monetary policy a more prominent role in demand management (Box 1).

Box 1. New Monetary Instruments

The central bank recently adopted the following measures which have led to a more active monetary policy:

- Letting the end-of-day settlement operations interest rates differ from the official intervention rate. The marginal lending rate is now 1/16 percent above the intervention rate and the marginal deposit rate is 1/16 under it.
- Introducing 3-month reverse repurchase operations. These operations, for which treasury bills are the only eligible collateral, set a 3-month interest rate and thus initiate a yield curve.
- Restricting the refinancing provided to commercial banks. While in the past, bids for liquidity were all satisfied, this is no longer the case. This policy is aimed at encouraging commercial banks to mobilize other financing (such as savings and loan recovery) and at stimulating the development of the money market.
- Broadening the range of eligible collateral for central bank refinancing. During the second half of 2001, the central bank accepted as collateral treasury bills, claims on priority sectors, and claims on other sectors in equal shares.
- Authorizing commercial banks to choose the term that best suits their refinancing needs. Terms range now from one to seven days for end-of-day settlement operations. Previously, banks could only benefit from seven-day operations.

29. More importantly, the central bank's proactive stance in 2001, in response to the emergence of pressures on the external position, marked a clear departure from the past, when the main objective was to ensure credit growth in line with nominal GDP growth. This objective was achieved through moral-suasion, leaving inflation to be determined by income policy and the external position largely a function of exchange rate policy in the context of restricted capital mobility.

30. **The mission encouraged the authorities to proceed in eliminating credit considerations from the conduct of monetary policy**[13] and in establishing a fully transparent monetary policy framework. This framework would need to: (a) adopt price stability as its main objective; (b) clearly identify the intermediate objective of the central bank as either M3 or M4; and (c) specify reserve money as the operational target. Work in this direction, with technical assistance from the IMF, has already started with improvements in the central bank's ability to project market liquidity conditions. However, the choice of the monetary target will need to take into full account possible instability in demand for money, and to develop reliable indicators of core or underlying inflation. The authorities have expressed interest in further technical assistance on how to choose the quantitative target for reserve money and how to define their intervention in the monetary markets with respect to this target.

31. Tunisia achieved great success with its exchange rate policies while avoiding the pitfalls of real exchange rate targeting thanks to strict fiscal and monetary policies, which did not allow a build-up of imbalances (see Selected Issues Paper SM/02/155, Chapter I). However, restricted capital mobility and limited demand shocks also helped in this regard. As shown by the selected issues paper, staff estimates suggest the actual exchange rate of the dinar followed closely that of the so-called equilibrium exchange rate.[14] Moreover, staff estimates based both on a structural model and an analysis of competitiveness indicators do not suggest that the current level of the real exchange rate is overvalued. **However, the mission encouraged the central bank to gradually reduce its intervention in the foreign exchange market after establishing a sound transparent monetary framework, with the objective of eventually letting the dinar float.** This would translate naturally into larger fluctuations in the exchange rate. The authorities pointed out that the current shallow depth of the foreign exchange market did not allow a significant reduction in the role played by the central bank. Thus, the mission and the authorities identified a number of steps that could be taken in the short term to broaden the scope of the market (Box 2). If adopted, these measures would be expected to increase exchange rate volatility, which, with a fully transparent framework for macroeconomic policies, would stimulate the development of forward exchange markets. However, before letting the dinar float, monetary policy should become the anchor for price and exchange rate expectations.

[13] One third of the amount the central bank provides to commercial banks through weekly liquidity auctions is still reserved for the refinancing of "priority" sectors.

[14] Following the approach developed by P. Lane and G.M. Milesi-Ferretti in WP/99/158 and WP/100/123, the staff estimates of the equilibrium exchange rates are based on panel data analysis of fundamental variables including terms of trade, net liabilities, and GDP per capita.

Box 2. Exchange Rate Policy

The following measures could be taken in the short-term to deepen the foreign exchange market and favor greater flexibility in setting the exchange rate, with the ultimate objective of letting the dinar float:

- Eliminating the remaining surrender requirement for export proceeds.
- Eliminating the obligation for commercial banks to place their foreign currency balances with the central bank at the end of each day (*Nivellement).*
- Ceasing the announcement by the central bank of exchange rates for the purchase and sale of foreign exchange at market opening; the central bank would only announce, at market closing, the average market rate.
- Allowing residents (not only exporters) to maintain foreign exchange-denominated deposits with commercial banks.

32. The authorities pointed out that controls on capital flows had already been relaxed for non residents. With the assistance of an MAE team, the mission took stock of the existing regulations concerning capital flows and discussed a sequencing of measures that could achieve the full convertibility of the dinar over a medium-term horizon. This proposed sequencing and related issues are discussed in detail in the Selected Issues Paper SM/02/155 (Chapter II), "Liberalization of the Capital Account in Tunisia: Progress Achieved and Prospects for Full Convertibility." While the mission encouraged the authorities to move forward with the agenda on external capital account liberalization, it stressed that **the following four conditions need to be satisfied before taking substantial steps in this direction**:

- The establishment of a transparent and solid framework for monetary policy that would anchor inflationary expectations.
- The establishment of a floating exchange rate regime, since a predetermined rule in exchange rate policy may give rise to implicit contingent government liabilities, among other problems.
- Further progress in strengthening the banking system and reducing existing vulnerabilities. In particular, banking supervision and prudential regulations would need to be adapted to the conditions that prevail under free capital movements.
- Progress in addressing budgetary rigidities since fiscal policy tightening would be needed to deal with the inflationary effects of possible large capital inflows.

33. However, the mission and the authorities identified a limited number of liberalization measures that could be taken in the immediate term. These measures, which are described in Box 3, could help to diversify the sources of balance of payments financing

without any foreseeable adverse impact on both macroeconomic conditions and the role of macroeconomic policies. The authorities indicated that they would adopt these measures as soon as external reserves reach a more comfortable level and the pressures on the external account abate.

Box 3. Early Capital Account Liberalization

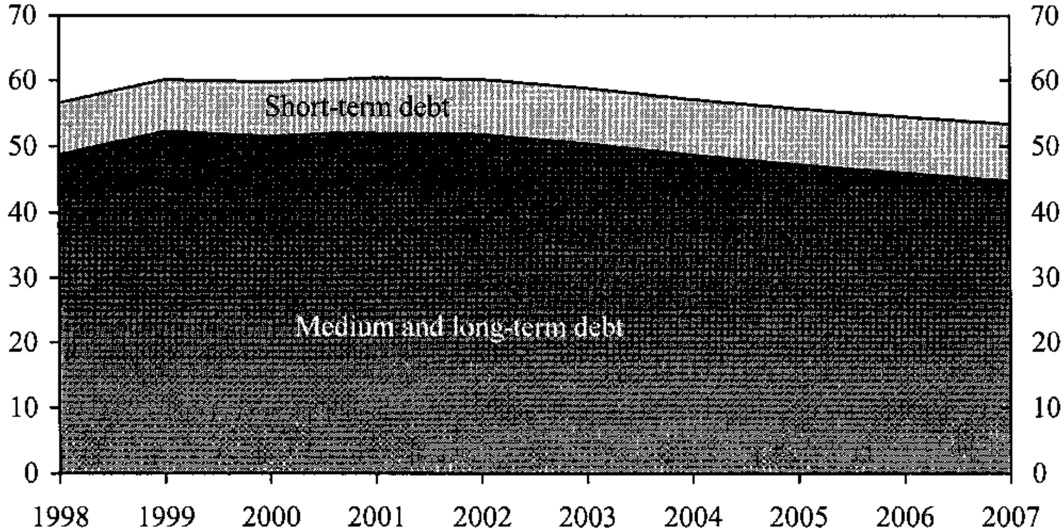
A few well-focused capital account liberalization measures could be adopted immediately. The following measures would not have to wait for a change in the current macroeconomic policy mix or a strengthening of the banking system, and they would help facilitate and diversify the financing of the current account deficit:

- Eliminating the authorization requirement for foreign investments that entails a participation above 50 percent of share capital.
- Allowing non residents to subscribe to a given percentage of newly issued government securities and enforce a global ceiling on the portion of outstanding securities held by non-residents through the depository.
- Allowing foreign medium and long-term borrowing by Tunisian firms and commercial banks that are quoted in the stock market or have obtained a favorable independent credit rating.

C. Medium-Term Outlook

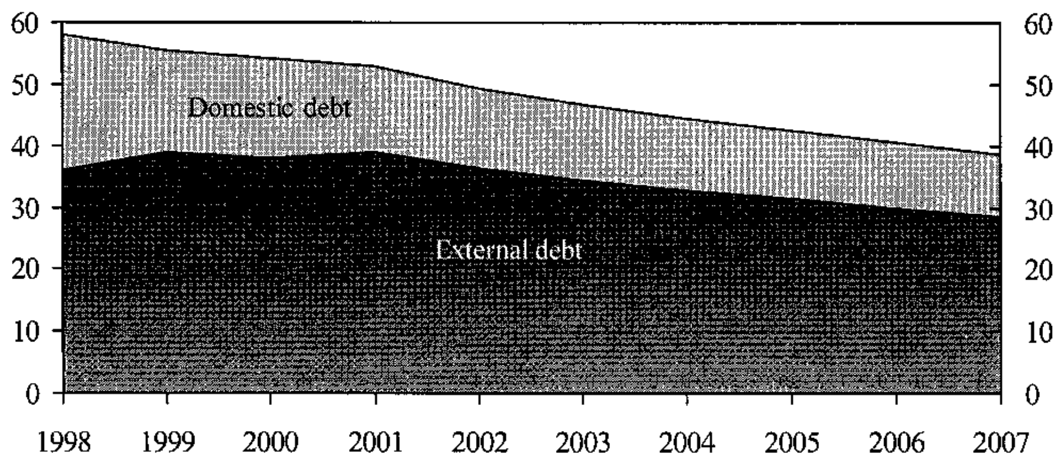
34. **The overriding policy objective is to lower unemployment over the medium term.** In this regard, the authorities are targeting an annual average growth rate of 5.6 percent over the 2002-06 period. While the authorities' efforts to tighten macroeconomic policies and adapt them to new challenges are necessary to achieve the growth targets, they are not sufficient. **An intensification of structural reforms and further progress in fiscal consolidation are also needed**. In particular, staff estimates that the authorities' growth objectives would require: (a) an increase in gross investment of about 1.5 percentage points of GDP over the period (based on average growth in labor and factor productivity of 2.9 and 1.3 percent, respectively); and (b) an improvement in national savings of about 3.1 percent of GDP with an adjustment in public savings of about 0.8 percentage points of GDP by 2006 (see Table 8). This would help lower the external current account to 3 percent of GDP by 2006, assuming average annual export growth of 5.9 percent from 2002 to 2006 on account of improved competitiveness and greater access to European markets. New borrowing would remain fairly constant over the medium term, allowing a gradual decline in the level of external debt to 53.3 percent of GDP at end-2007 from 60.2 percent at end-2001 (Figure 15, Table 9). The envisioned fiscal adjustment would also allow the central government deficit to decline from 3.2 percent of GDP in 2001 to 1.6 percent of GDP by 2007 (see Table 8), while consolidated central government debt would decline from 53 percent of GDP in 2001 to 39 percent of GDP by 2007 (Figure 16).

Figure 15. Tunisia: External Debt, 1998-2007
(Percent of GDP)



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

Figure 16. Tunisia: Central Government Debt,
1998-2007
(Percent of GDP)



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

35. **The medium-term outlook presents risks linked to both a possible protracted slow-down in tourism flows and/or reduced access to international capital**. The staff has prepared a worse case scenario to illustrate the impact on external sustainability in the event these risks were to materialize (Text Table 1). Under this scenario, tourism flows are held constant after the drop in 2002; annual GDP growth is lowered over the medium term

by 1.0 percent; and the cost of borrowing on international markets is raised by about 300 basis points over the period (international reserves are held constant). As a result, the current account deficit rises to 5.1 percent of GDP in 2007 compared to 2.9 percent in the base case scenario; total external debt rises slightly over the 2002-2007 period to 53.2 percent of GDP compared to a decline of over 7 percent of GDP to 44.7 percent of GDP under the base case; and the debt service ratio rises to 18.7 percent in 2007 compared to 14.5 percent in the base case. On the fiscal front, the central government deficit would be 3.2 percent of GDP in 2007 compared to 1.6 percent of GDP, and interest payments would represent about 3.3 percent of GDP in 2007 compared to 2.2 percent of GDP under the base case scenario. While not catastrophic, these results show that indicators of external vulnerability deteriorate noticeably relative to the baseline scenario outlined by the staff. This would call for continued tightening in monetary and fiscal policies after 2002.

IV. Structural Reforms

36. **In order to meet the savings and investment goals required to reach the growth target**, the authorities would need to increase government savings, persevere with ongoing structural reforms, and accelerate measures in certain key areas.

Text Table 1. Tunisia: Alternative Medium-Term Scenario, 2002-07

	Projections					
	2002	2003	2004	2005	2006	2007
Base case scenario						
Real GDP growth (percent change)	3.8	6.4	6.1	5.8	6.0	6.0
Current account balance/GDP (percent)	-4.6	-3.8	-3.1	-3.0	-3.0	-2.9
External debt (in billions of U.S. dollars)	10.6	11.2	11.6	12.1	12.7	13.3
External debt/GDP (in percent)	51.8	50.4	48.7	47.2	45.9	44.7
Debt service ratio (as percent of export of goods and services)	16.7	15.8	16.5	15.2	15.3	14.5
Worse case scenario						
Real GDP growth (percent change)	3.8	5.4	5.1	4.8	5.0	5.0
Current account balance/GDP (percent)	-4.6	-4.5	-4.2	-4.5	-4.9	-5.1
External debt (in billions of U.S. dollars)	10.6	11.3	12.0	12.8	13.9	15.0
External debt/GDP (percent)	51.8	51.6	51.3	51.6	52.2	53.2
Debt service ratio (as percent of export of goods and services)	16.7	16.2	17.6	17.1	18.3	18.7

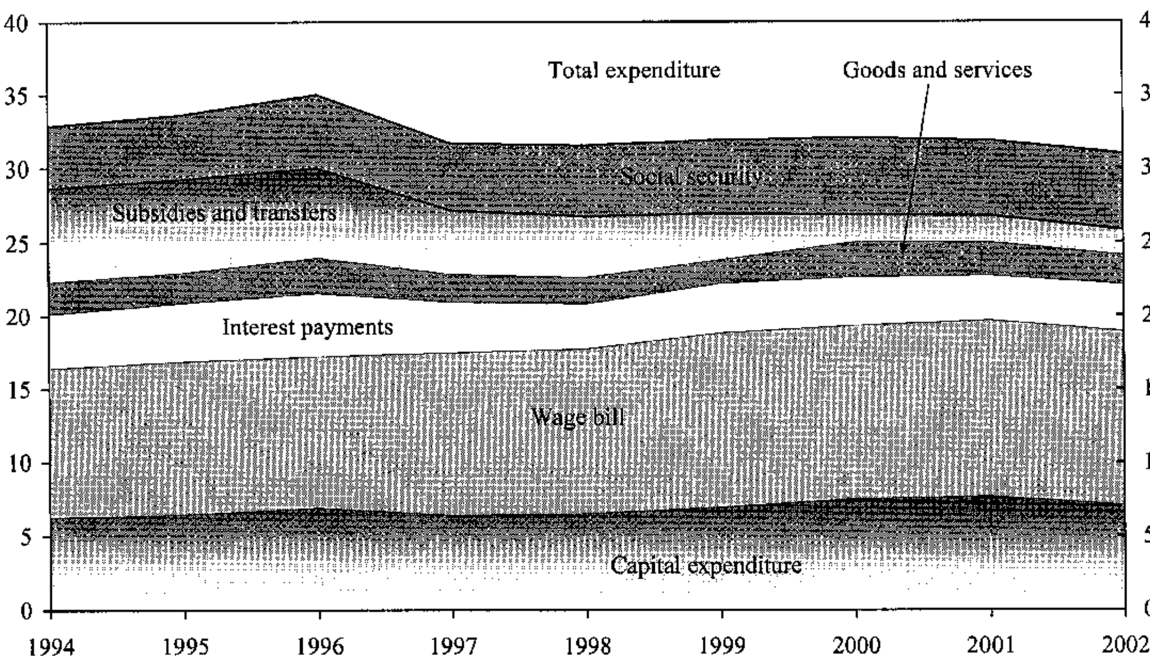
Sources: Tunisian authorities; and Fund staff estimates and projections.

A. Structural Fiscal Reforms

37. To achieve a deeper but not unreasonable adjustment in the fiscal position, a greater commitment is needed to address existing fiscal rigidities since the scope for compressing discretionary spending (4 percent of GDP) is fairly limited.[16] **The principal budget rigidity relates to the wage bill**, which, for the consolidated government, increased from 11.8 percent of GDP in 2000 to 12 percent of GDP in 2001. The authorities stressed that they have reduced the recruitment but have raised the caliber of new recruits, hence overall wage costs have not declined (see Figure 17). The staff feels that more fundamental reforms are necessary to lighten the burden of the wage bill on the budget while improving the efficiency of the civil service. The staff urged the authorities to undertake a reform of the civil service and the remuneration system as soon as possible.

Figure 17. Tunisia: Consolidated Government Expenditure, 1994-2002 1/

(In percent of GDP)



Source: Data provided by Tunisian authorities and Fund staff estimates.

38. **Price liberalization should constitute a more important policy objective for the authorities:** approximately 19 percent of all prices are still administered by the state and this share has not changed since 1997. It is true that the cost to the budget, at 0.8 percent of

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

GDP, is not particularly high, and that the authorities usually raise these prices to some degree every year. However, these subsidies could be diverted to a more productive use or toward a better targeted social purpose. More importantly, controlled prices distort market signals regarding demand and supply trends.

39. **On the revenue side, the general improvement in tax buoyancy in recent years** attests to the tax reform efforts of the authorities since the mid-1990s. The implementation in 2002 of the new Fiscal Code is expected to improve revenue performance further by strengthening compliance and collection. In addition, a number of minor tax changes are in store for 2002, including extending the value-added tax (VAT) to the telecommunication sector and subjecting public procurement to taxation. However, the authorities also plan to introduce or extend a number of tax holidays.[17] The staff considers the rationalization of tax expenditures (worth roughly 1.7 percent of GDP) already an area overripe for reform, both in the interests of economic efficiency and budget savings. Likewise, the tax treatment of the domestic (on-shore) and export (off-shore) sectors should be harmonized in the short term in order to permit a level playing field for all firms. Indeed, the authorities are preparing an action plan on revising investment promotion and incentives under the ECAL III program.

40. The social security surplus stabilized at 0.5 percent of GDP in 2001, although the public sector caisse (*Caisse Nationale de Retraite et Prévoyance Sociale* (CNRPS)) ran into deficit in 2000, earlier than anticipated. The authorities have launched a wide-ranging study with domestic and foreign experts (including the World Bank) to assess the financial prospects of the social security system and to recommend fundamental policy reforms to put them on sound footing. It will take some time for a national consultative process to ensue before reforms are actually implemented. Consequently, the authorities recently passed a number of short term measures to help the CNRPS maintain balance until 2005 (Box 4).

[17] Some new revenue measures: a tax credit on investment by companies benefiting from *mise à niveau*; deduction of capital gains on redemption of certain types of stock by banks (extended) and exemption of income tax on *Sociétés d'Investissement à Capital Variable* (SICAV).

Box 4. Reform of the Social Security System

The policy objectives of the *Caisses de Sécurité Sociale* (CSS) are to: (a) expand the reach of social policies from 84 percent of the population to 90 percent by 2006; (b) improve social benefits, particularly in response to job dislocation; and (c) preserve the financial balances of the two funds, the public sector *Caisse Nationale de Retraite et Prévoyance Sociale* (CNRPS) and the private sector *Caisse Nationale de Sécurité Sociale* (CNSS).

The **CNRPS** incurred a small deficit in 2000, earlier than anticipated, due to the forces of the "pay as you go" system: (a) higher life expectancy; (b) decline in the ratio of employed to retired (absorption of workers retrenched by privatization and slow-down in the rate of recruitment); (c) demographic-induced acceleration in the rate of retirement; and (d) increase in the average pension. The **CNSS** has a comfortable surplus since benefits have been frozen since 1986 and the rate of population growth has slowed considerably over this period. However, the surplus is on a declining trend and forecast to turn into deficit by 2012. Over the medium term, the CNSS must face the challenges of an increase in the number of subscribers who will be eligible for social benefits and major deficiencies in the system of medical coverage.

Fundamental reform: The CSS launched a wide-ranging study in 2002 with trained experts from Tunisia and abroad (including the World Bank) to assess the financial prospects of both *Caisses* and to prepare comprehensive policy recommendations to put them on sound, sustainable footing. This will involve reform mainly in the areas of medical insurance and retirement pension plans. The study is expected to be finalized by end-2002, after which time an extensive national consultation process will ensue. Actual reforms are thus not likely to occur until several years later. The authorities are also studying the actual coverage of social benefits to ensure that the coverage of the system is reaching its intended targets.

Short-term measures: While awaiting the results of the study, the government recently implemented the following measures to help the CNRPS maintain balance until 2005:

- Increase in the contribution rate by 2.5 percent over 3 years, split 1 percent by employees and 1.5 percent by employers. Half of this increase will be implemented in 2002, with the remainder to be split in 2003 and 2004. This increase also applies to special funds managed by the CNRPS.
- Reduced pension benefits slightly through changes in the formula for calculating pension benefits.

B. Other Structural Reforms

41. The general findings of the Financial Sector Assessment Program (FSAP) indicate that although the banking system has been strengthened, it is not yet on solid ground. As discussed in the Financial Sector Stability Assessment (FSSA), there remains considerable exposure to credit risk, nonperforming loans (NPLs) are high, and the level of provisioning remains a problem. While progress has been made recently at restructuring and modernizing the sector, increasing bank efficiency, and improving loan recovery, the banking system needs to be put on a more commercial footing. This transformation is essential for the success of the proposed reform in monetary and exchange rate policy, and is also a precondition for the effective application of banking supervision and prudential regulation. Box 5 provides a summary of the recommendations in the FSSA designed to strengthen the financial sector.

Box 5. FSSA Recommendations

The FSSA recommends the following measures be taken to strengthen the banking sector and improve the financial system's ability to cope with the challenges of growing regional and global integration:

- make a firmer commitment to market funding of the fiscal deficit.;
- complete as soon as possible the action plan aimed at modernizing the insurance sector;
- expedite the enforcement of judgments, realization of collateral and claims;
- adopt a legal framework to combat money laundering;
- reduce the extent of state ownership in the financial sector and remove the obstacles to the establishment of foreign financial institutions;
- encourage better provisioning policies by removing limits on tax deductibility and reduce reliance on real estate collateral until appropriate judicial procedures recovery are in place;
- strengthen the supervisory frameworks with expanded training and the promotion of greater functional independence;
- devise a framework for bank crisis management; and
- conduct an in-depth study of a deposit insurance mechanism.

42. **Privatization results fell short of objectives in 2001.** Of the 41 enterprises scheduled for privatization, only about 15 small companies were sold. **Looking forward, ECAL III is promoting further privatization and structural reform.**[18] The authorities continue to place efforts in the telecom sector: after selling the second GSM license, they intend to sell a share of *Tunisie Telecom* and, under ECAL III, they will amend the telecommunications code and sell a satellite license (V-SAT). Another element of the loan involves measures to improve the private investment climate. In addition, the authorities have undertaken a study of labor-market trends and government policies to identify factors, which may have resulted in a low elasticity of employment to economic growth.

43. **While Tunisia made some progress at reducing MFN tariffs in 2001, the economy remains highly protected.** In addition, customs procedures remain cumbersome. While trade liberalization under the AAEU has so far proceeded on schedule, the staff urged the authorities to move forward in other areas of the accord, namely trade in services, competition rules, and the treatment of state monopolies engaged in commercial activities. In addition, the reduction in tariffs with the EU should be accompanied by further tariff reduction on products from non-EU countries and by harmonization of the array of different bilateral trade accords in order to avoid trade distortion. The authorities intend to modernize and simplify their customs procedures and are interested in technical assistance from the Fund in this area. Finally, Tunisia is participating in a regional trade facilitation initiative with Bank and Fund support.

44. **The government's industrial restructuring program "*mise à niveau*" has by most measures contributed** to upgrading the competitiveness of domestic producers. However, the staff stressed that the approach of providing public assistance directly to firms should have run its course by now and could be wound up. Efforts should now focus fully on measures to create an environment where private companies can flourish according to the forces of demand and supply.

V. Statistical and Other Issues

45. **Considerable progress has been made to improve the quality and the dissemination of statistical information.** Tunisia subscribed to the Special Data Dissemination Standard (SDDS) in June 2001, which has resulted in significant improvements in the frequency and coverage of Tunisia's national accounts, labor market and fiscal data. While Tunisia generally provides good economic and financial statistics for surveillance, further information is required regarding the performance of non-financial public enterprises in order to allow for full and effective surveillance. While there appears to be no major financial imbalance in the public enterprise sector taken as a whole, more information on the operational and financial position of individual enterprises is needed to

[18] The loan was approved in December 2001 for US$252 million, but involves additional grants of EUR 80 million from the EU and loans of EUR 216 million from the African Development Bank.

assess their viability and to identify possible contingent liabilities for the budget. More detailed labor market and wage information would also be helpful.

46. **The authorities completed the IMF questionnaire on anti-money laundering (AML) and combating the financing of terrorism (CFT).** Tunisia has taken a number of initiatives in this area, although the staff urged the authorities to establish a legislative framework unifying these measures as soon as possible. Attachment I provides a summary of the existing AML/CFT framework in Tunisia.

47. **The authorities provide information on environmental programs and military spending.** With respect to the environment, all programs covered in the budget are executed by a state agency. In 2001, expenditure on the environment was estimated at 90 million dinars (0.3 percent of GDP), including current spending, capital investment, and subsidies to the private sector. Security-related spending is estimated at 3.9 percent of GDP in 2001 (1.7 percent of GDP for "defense," and 2.2 percent of GDP for "order and public security").

VI. Staff Appraisal

48. **Tunisia has achieved an enviable record in terms of economic performance and living standards.** The Tunisian experience shows that the pursuit of structural reforms in a stable macroeconomic environment can produce concrete results. An outward-oriented growth strategy and significant economic diversification have raised per-capita income, reduced poverty, and bring access to basic services, including housing and education, to virtually the entire population. The Tunisian authorities should be commended for the success in their efforts, which have made Tunisia's social and economic achievements stand out in the region.

49. **The Tunisian authorities are now facing a two-pronged challenge. On the one hand, they need to preserve Tunisia's gains in a difficult international context, compounded by a fourth year of drought that will bring agricultural production to a record low.** On the other hand, while their model of sound macroeconomic management and gradual reform has worked extremely well so far, economic integration in the context of the AAEU will fundamentally modify the environment for macroeconomic policies and require a faster pace of structural reform to further improve Tunisia's economic performance over the medium term.

50. **The immediate task for macroeconomic management is containing the momentum in domestic demand, which has placed pressures on the external position and lowered external reserves.** The objective is to avoid a deterioration in Tunisia's external indicators of vulnerability. The central bank has already started to tighten the monetary stance to achieve this objective. The staff encourages the authorities to continue in this direction during the rest of the year. Tighter monetary conditions, as envisioned in the central bank's monetary program for the year, will translate into higher interest rates, which will help to curb domestic demand.

51. **It would be desirable for fiscal policy to complement monetary policy in demand management, with a shift away from its current broadly neutral stance.** The staff was encouraged to learn that the authorities have identified possible measures to bring about expenditure savings. In order to have an impact during 2002, these would need to be taken as soon as possible. The staff fully supports the authorities' intention to take further measures to offset the adverse impact that the forthcoming triennial wage-negotiation round could have on the budgetary position in 2002. Moreover, the authorities should take into full account any potential costs of banking restructuring.

52. **The strong recent performance of Tunisian exports suggests that exchange rate policy has worked well and that the current level of the dinar is appropriate in terms of competitiveness.** The staff concurs with the authorities that, under the current conditions, further exchange rate flexibility should not substitute for the fiscal and monetary adjustment needed to bring domestic demand under control.

53. **Achieving higher economic growth will require increased investment and a faster pace of structural reform over the medium term.** Since increased domestic savings can reasonably finance only part of these investment needs, the authorities have decided to gradually liberalize capital movements to tap foreign savings. The staff encourages the authorities to move forward in this direction, since further opening up of the economy will allow Tunisia to take full advantage of the opportunities provided by international markets. However, as a result, the macroeconomic policy environment will change substantially and, consequently, the role of monetary and exchange rate policies needs to be revisited.

54. **The central bank has already adopted a more active role in demand management by cutting its refinancing to commercial banks and breaking the tradition of automatic refinancing.** However, a clear framework for monetary policy, with price stability as its main objective, and well-defined intermediate and operational targets, still needs to be established.

55. **Once this framework is in place, the central bank could start gradually reducing its intervention in the foreign exchange market, with the objective of eventually letting the dinar float.** The authorities have indicated that they intend to take measures soon to deepen the foreign exchange market and reduce the central bank's role in the market.

56. **Before opening up the external capital account, the authorities should continue to strengthen and adapt prudential regulations and banking supervision to the new environment.** Nevertheless, the staff encourages the authorities to adopt limited capital liberalization measures that would help diversify the source of balance of payment financing without having any adverse impact on macroeconomic conditions.

57. **The success in fiscal consolidation during the second half of the 1990s has placed the fiscal position on a sustainable path.** However, there is still considerable room for improving both the structure of budgetary expenditures and for increasing government savings. Higher government savings are necessary to attain the authorities' medium-term

growth objective, without relying excessively on foreign savings. The most pressing issue is the excessive size of the wage bill, which a comprehensive civil service reform could help to reduce. Further progress in domestic price liberalization would not only reduce outlays for subsidies and free budgetary resources for more productive purposes, but also reduce price distortions which do not allow market incentives to operate properly.

58. **The buoyancy of tax collections reflects in part the strong momentum in economic activity, but also the tax reform efforts which have taken place since the mid-1990s.** The staff welcomes the authorities' intention to reconsider, in collaboration with the World Bank, the role of tax holidays and the differential tax treatment reserved to the off-shore sector. This could yield significant additional revenues, but more importantly could ensure that the present dual economy, with an on-shore and off-shore sector, does not become a permanent feature of the Tunisian economy.

59. **The authorities have already made good progress in strengthening the financial sector consistent with the recommendations of the FSAP.** If continued, these efforts should succeed in fully addressing the financial system's main vulnerabilities: a considerable exposure to credit risk and a high level of NPLs.

60. **The authorities are pursuing their structural reform and privatization agenda in the context of the World Bank ECAL III.** The recent sale of a second GSM license constitutes an important step toward the liberalization of the telecommunication sector that should unleash not only significant growth potential in the sector but also improve economy-wide productivity.

61. **The still high unemployment rate makes labor market reform a priority**. The authorities have undertaken a study, in collaboration with the World Bank, to identify institutional obstacles to employment expansion. This study would need to reexamine both the role of the wide range of existing active labor market policies and that of the centralized wage negotiation system.

62. **The authorities have chosen to liberalize trade in the context of the AAEU and other bilateral and regional agreements**. This approach has, however, left high external MFN tariffs that Tunisia should further lower to avoid costly economical trade distortions. Efforts toward regional trade integration would also help limit these distortions. Thus, the staff welcomes the authorities' decision to actively participate in Fund supported trade facilitation initiative in the Maghreb. In this context, simplifying and modernizing customs procedures could favor trade with the Maghreb countries.

63. **The authorities have fully embraced Fund transparency policy**. The staff congratulates the authorities for their decision to publish both the concluding statement and the staff report from the Article IV consultation discussions. This decision, together with the early subscription to the Fund SDDS, has certainly made financial markets aware of Tunisia's sound macroeconomic policies and, hence, helped to obtain favorable spreads on the recently issued bond.

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

Table 1. Tunisia: Basic Economic and Financial Indicators, 1997–2002

	1997	1998	1999	2000	Est. 2001	Proj. 2002
	(Annual percent change; unless otherwise indicated)					
Production and income						
Nominal GDP	9.6	8.0	9.4	8.2	7.8	6.5
Real GDP	5.4	4.8	6.1	4.7	5.0	3.8
GDP deflator	4.0	3.0	3.1	3.3	2.7	2.6
Consumer price index (CPI), average	3.7	3.1	2.7	3.0	1.9	3.4
Gross national savings (in percent of GDP)	23.3	23.5	24.2	23.1	23.3	22.5
Gross investment (in percent of GDP)	26.4	26.9	26.3	27.3	27.5	27.1
External sector (percent change)						
Exports of goods, f.o.b. (in US$)	0.7	3.1	2.3	-0.4	13.1	1.5
Imports of goods, f.o.b. (in US$)	3.2	5.0	1.5	1.0	11.0	1.3
Exports of goods, f.o.b. (volume)	10.1	6.3	6.7	7.3	15.7	3.7
Import of goods, f.o.b. (volume)	8.7	5.4	5.8	6.5	13.6	2.9
Trade balance (in percent of GDP)	-10.3	-10.9	-10.3	-11.5	-11.8	-11.5
Current account, excl. grants (in percent of GDP)	-3.1	-3.4	-2.1	-4.2	-4.2	-4.6
Terms of trade (deterioration -)	-3.6	-2.7	0.0	-2.2	0.1	-0.6
Real effective exchange rate (depreciation -) 1/	-0.1	-0.1	1.0	-0.6	-2.5	...
	(In percent of GDP)					
Consolidated central government 2/						
Revenue, excluding grants	28.4	29.2	29.1	29.3	29.5	29.2
Total expenditure and net lending	32.6	32.0	31.7	32.7	32.3	31.4
Consolidated balance, excl. grants and privatization	-4.2	-2.9	-2.6	-3.4	-2.8	-2.2
Consolidated balance, incl. grants and privatization	-3.8	-0.6	-2.3	-2.0	-2.5	0.6
Central government balance, excl grants and privatization 3/	-4.6	-3.6	-3.9	-3.8	-3.5	-2.8
	(Annual percent change; unless otherwise indicated)					
Money and credit						
Credit to the economy	10.0	8.7	8.5	8.0	10.4	6.6
Broad money (M3)	14.2	6.0	18.6	13.2	11.4	7.8
Velocity of circulation (GDP/M3)	1.90	1.94	1.79	1.71	1.65	1.63
Liquidity aggregate (M4)	8.7	9.3	9.4	4.5	6.5	6.2
Velocity of circulation (GDP/M4)	1.54	1.52	1.52	1.57	1.59	1.60
Interest rate (money market rate, in percent)	6.90	6.88	5.88	5.88	6.02	...
Official reserves						
Gross official reserves (in billions of US$, end-period)	1.99	1.87	2.29	1.83	1.98	2.41
In months of imports of goods, c.i.f.	3.0	2.7	3.2	2.6	2.5	3.0
Total external debt (Short, medium and long-term)						
External debt (in billions of US$)	11.1	11.6	11.8	11.5	11.8	12.3
External debt (in percent of GDP)	60.7	56.8	59.7	59.6	60.2	60.1
Debt service ratio (in percent of exports of good and services)	19.4	19.2	18.5	22.6	15.6	16.7
Debt service ratio (in percent of current receipts)	17.4	17.2	16.5	20.2	14.1	15.0
Financial market indicators						
Stock market index (Tunindex, end of period)	...	917	1193	1443	1267	...
Memorandum items:						
GDP at current prices (in billions of US$)	18.90	19.84	20.77	19.47	20.00	20.60
Exchange rate: dinar/US$ (period average)	1.11	1.14	1.19	1.37	1.44	...
Total short term external debt/reserves (in percent)	73.9	84.4	67.1	86.2	79.0	70.6
Short term debt incl. amortization/reserves (in percent)	121.8	140.8	109.5	159.9	126.0	115.2

Sources: Data provided by the Tunisian authorities; includes Fund staff projections for 2001 and 2002.

1/ IMF Information Notice System (average).
2/ Includes the social security accounts (CSS), unless otherwise indicated.
3/ Excludes the social security accounts (CSS).

Table 2. Tunisia: Balance of Payments, 1996–2002

(In millions of U.S. dollars)

	1996	1997	1998	1999	2000	Est. 2001	Proj. 2002
Current account	-479	-593	-676	-442	-814	-844	-944
Trade balance	-1,761	-1,955	-2,154	-2,138	-2,246	-2,366	-2,378
Exports	5,519	5,559	5,733	5,864	5,840	6,606	6,706
Energy	578	503	367	419	706	610	524
Nonenergy	4,940	5,057	5,366	5,445	5,134	5,996	6,181
Imports	-7,280	-7,514	-7,887	-8,003	-8,086	-8,971	-9,084
Energy	-607	-597	-396	-540	-874	-885	-706
Nonenergy	-6,673	-6,918	-7,491	-7,462	-7,212	-8,086	-8,378
Services and transfers (net)	1,283	1,362	1,478	1,696	1,432	1,521	1,434
Nonfactor	1,563	1,528	1,555	1,741	1,610	1,617	1,404
Of which: Tourism	1,452	1,415	1,506	1,641	1,528	1,629	1,466
Factor services and transfers (net)	-281	-166	-77	-45	-178	-96	30
Of which: Workers' remittances	820	765	793	858	796	851	881
Of which: Interest payments on external debt	-661	-535	-541	-530	-515	-491	-484
Capital and financial account	835	786	478	910	463	1,066	1,385
Excluding grants	789	692	395	837	455	1011	1284
Capital account	37	76	60	59	3	51	94
Financial acount	798	710	417	850	460	1,015	1,291
Direct foreign investment (net)	299	442	685	357	731	420	945
Medium and long-term loans (net)	400	456	-111	468	223	680	397
Disbursement	1,435	1,452	920	1,501	1,597	1,639	1,486
Amortization	-1,034	-997	-1,032	-1,033	-1,374	-959	-1,089
Short-term	169	-20	-143	250	-348	-50	-50
Errors and omissions	-71	-168	-13	-224	-145	-35	0
Overall balance	356	193	-198	467	-351	222	441
Changes in gross reserves 1/	-300	-68	119	-423	465	-154	-431
Use of IMF resources	47	50	50	50	40	31	0
Other assets, net (increase -)	-346	-118	69	-473	425	-185	-431
Memorandum items:							
Current account balance/GDP (in percent)	-2.4	-3.1	-3.4	-2.1	-4.2	-4.2	-4.6
Reserves (in billions of US$)	1.9	2.0	1.9	2.3	1.8	2.0	2.4
Reserves in months of imports	3.0	3.0	2.7	3.2	2.6	2.5	3.0
External medium- and long-term debt (in billions of US$)	9.9	9.6	10.0	10.3	9.9	10.2	10.6
External medium- and long-term debt/GDP (in percent)	51.8	52.8	48.8	52.2	51.5	52.3	51.8
External short-term debt (in billions of US$)	1.5	1.5	1.6	1.6	1.6	1.6	1.7
External short-term debt/GDP (in percent)	7.8	7.9	8.0	7.5	8.2	7.9	8.3
Debt service ratio (as percentage of exports GNFS)	21.4	19.4	19.2	18.5	22.6	15.6	16.7
Real goods export growth (in percent)	-2.4	10.1	6.3	6.7	7.3	15.7	3.7
Nonenergy	-3.6	12.9	7.0	5.6	6.3	19.0	3.4
Real goods import growth (in percent)	-2.5	8.7	5.4	5.8	6.5	13.6	2.9
Nonenergy	-2.2	9.0	7.2	4.1	7.4	13.6	3.3

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

1/ Differs from the overall balance because of valuation effects.

Table 3. Tunisia: Consolidated Central Government, 1997–2002 1/

	1997	1998	1999	2000	Est. 2001	Bud. 2002	Staff 2002
	(In millions of Tunisian dinars)						
Total revenue	5,933	6,579	7,187	7,821	8,490	8,959	8,959
Tax revenue	4,231	4,770	5,208	5,678	6,240	6,584	6,584
o/w Income taxes	1,113	1,294	1,387	1,597	1,831	2,020	2,020
VAT	1,170	1,443	1,625	1,770	2,101	2,234	2,234
Trade taxes	736	751	731	642	876	878	878
Social Security Contributions	993	1,114	1,220	1,342	1,477	1,498	1,498
Nontax revenue	709	695	759	800	774	876	876
Total expenditure and net lending	6,804	7,223	7,828	8,725	9,306	9,645	9,631
Total Expenditure	6,618	7,115	7,866	8,546	9,162	9,705	9,477
Current expenditure	5,283	5,644	6,153	6,544	6,953	7,536	7,308
Wages and Salaries	2,320	2,533	2,930	3,152	3,446	3,624	3,624
Goods and services	399	415	395	632	653	614	614
Interest payments	720	692	840	887	884	976	976
Transfers and subsidies	1,843	2,004	1,989	1,873	1,970	2,136	2,094
o/w Social security benefits	946	1,076	1,223	1,386	1,462	1,614	1,571
Unallocated Credits		0	0	0	0	185	0
Capital expenditure	1,335	1,471	1,713	2,003	2,209	2,169	2,169
Direct Investment	955	1,408	1,078	1,183	1,331	1,292	1,292
Capital transfers and equity	381	63	635	820	878	878	878
Net lending	186	108	-38	179	144	-60	154
Consolidated deficit (-), excluding grants, privatization	-871	-644	-641	-905	-816	-686	-672
Grants	66	89	83	34	78	75	75
Privatization proceeds 2/	3	418	1	342	11	50	774
Consolidated deficit (-), including grants, privatization	-803	-136	-557	-528	-727	-561	177
Financing	803	136	557	528	727	561	-177
Foreign	492	4	350	-51	1,001	314	314
Domestic	311	132	207	579	-274	247	-491
	(In percent of GDP)						
Total revenue	28.4	29.2	29.1	29.3	29.5	29.2	29.2
Tax revenue	20.2	21.1	21.1	21.3	21.7	21.5	21.5
o/w Income taxes	5.3	5.7	5.6	6.0	6.4	6.6	6.6
VAT	5.6	6.4	6.6	6.6	7.3	7.3	7.3
Trade taxes	3.5	3.3	3.0	2.4	3.0	2.9	2.9
Social Security Contributions	4.8	4.9	4.9	5.0	5.1	4.9	4.9
Nontax revenue	3.4	3.1	3.1	3.0	2.7	2.9	2.9
Expenditure and net lending	32.6	32.0	31.7	32.7	32.3	31.5	31.4
Current expenditure	25.3	25.0	24.9	24.5	24.2	24.6	23.9
Wages and Salaries	11.1	11.2	11.9	11.8	12.0	11.8	11.8
Goods and services	1.9	1.8	1.6	2.4	2.3	2.0	2.0
Interest payments	3.4	3.1	3.4	3.3	3.1	3.2	3.2
Transfers and subsidies	8.8	8.9	8.1	7.0	6.8	7.0	6.8
o/w Social security benefits	4.5	4.8	5.0	5.2	5.1	5.3	5.1
Unallocated Credits		0.0	0.0	0.0	0.0	0.6	0.0
Capital expenditure	6.4	6.5	6.9	7.5	7.7	7.1	7.1
Net lending	0.9	0.5	-0.2	0.7	0.5	-0.2	0.5
Consolidated deficit (-), excluding grants, privatization	-4.2	-2.9	-2.6	-3.4	-2.8	-2.1	-2.2
Grants	0.3	0.4	0.3	0.1	0.3	0.2	0.2
Privatization proceeds (net) 2/	0.0	1.9	0.0	1.3	0.0	0.2	2.5
Consolidated deficit (-), including grants, privatization	-3.8	-0.6	-2.3	-2.0	-2.5	-1.8	0.6
Memorandum items:							
Budget balance (excl. CSS, grants and privatization)	-4.6	-3.6	-3.9	-3.8	-3.5	-2.7	-2.8
Government debt 3/	62.2	58.2	55.5	54.3	52.9	51.5	49.2

Sources: Tunisian authorities; and Fund staff estimates.

1/ Includes special funds, *fonds de concours*, and the social security system (except where indicated).

2/ Privatization in 2002 includes sale of GSM license (US$454 million) and sale of UIB (TD 100 million).

3/ Gross debt: includes debt held by social security funds; excludes debt of public enterprises.

Table 4. Tunisia: Central Bank Balance Sheet, 1996–2001

	1996	1997	1998	1999	2000	2001
	(In millions of dinars; end of period)					
Foreign assets	1,938	2,304	2,080	2,895	2,557	2,935
International reserves (gold, SDRs, foreign exchange)	1,918	2,282	2,058	2,871	2,532	2,909
Other foreign assets 1/	20	22	21	23	25	26
Claims on government 2/	103	58	78	79	132	147
Claims on development banks	4	0	0	0	0	0
Claims on other private sector	969	888	807	727	646	565
Claims on deposit money banks	154	93	93	93	449	854
Assets = Liabilities	3,168	3,343	3,058	3,793	3,784	4,501
Reserve money	2,264	2,446	2,187	2,840	2,698	3,159
Currency outside banks	1,472	1,592	1,695	1,994	2,229	2,376
Currency with banks	84	78	84	96	146	144
Banks' deposits	673	734	363	707	289	601
Claims of development banks and other fin. inst.	34	40	42	41	30	34
Demand deposits	1	1	2	2	3	4
Term deposits	33	39	41	39	27	30
Deposits of nonbank public	1	2	2	2	3	3
Foreign liabilities	272	255	174	180	261	272
Government deposits and currency holdings	254	232	242	243	206	392
Counterpart funds	47	67	80	81	174	201
Allocation of SDRs	49	53	53	59	63	63
Capital accounts	84	89	98	44	54	62
Other items (net)	198	201	224	346	328	353

Source: Tunisian authorities.

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

Table 5. Tunisia: Monetary Survey, 1996–2002 1/

	1996	1997	1998	1999	2000	Actual 2001	Proj. 2002
			(In millions of dinars; end of period)				
Foreign assets (net)	1,137	1,538	1,373	1,842	1,408	1,597	2,278
Foreign assets	2,550	3,075	2,881	3,776	3,598	3,811	4,512
Foreign liabilities	-1,413	-1,537	-1,508	-1,934	-2,190	-2,214	-2,233
Net domestic assets	8,481	9,443	10,266	11,965	14,226	15,815	16,490
Domestic credit	13,685	15,306	16,454	18,380	20,576	22,324	23,299
Credit to the government (net)	963	1,314	1,251	1,892	2,773	2,673	2,360
Credit to the economy	12,722	13,992	15,203	16,488	17,804	19,651	20,939
Other items (net)	-5,204	-5,863	-6,188	-6,415	-6,351	-6,509	-6,809
Money plus quasi-money (M2)	8,764	10,162	10,726	12,816	14,550	16,051	17,214
Money	3,981	4,474	4,790	5,554	6,128	6,744	…
Currency	1,473	1,594	1,695	1,994	2,228	2,376	…
Demand deposits	2,509	2,880	3,095	3,560	3,899	4,367	…
Quasi-money	4,783	5,688	5,936	7,262	8,423	9,307	…
Long-term deposits	854	819	913	991	1,083	1,361	1,554
Broad money (M3) 2/	9,618	10,981	11,639	13,806	15,634	17,412	18,768
Liquid treasury bills	2,243	2,066	2,525	1,800	815	265	75
Short-term commercial paper	631	530	673	627	511	381	341
Liquidity aggregate (M4) 3/	12,492	13,576	14,836	16,234	16,960	18,057	19,184
			(Annual rate of change in percent)				
Foreign assets (net)	33.2	35.2	-10.7	34.1	-23.5	13.4	42.7
Domestic credit	12.7	11.8	7.5	11.7	11.9	8.5	4.4
Credit to government (net)	-4.0	36.4	-4.8	51.2	46.5	-3.6	-11.7
Credit to the economy	14.2	10.0	8.7	8.5	8.0	10.4	6.6
Money and quasi-money (M2)	13.9	15.9	5.6	19.5	13.5	10.3	7.2
Broad money (M3)	13.9	14.2	6.0	18.6	13.2	11.4	7.8
Liquidity aggregate (M4)	13.0	8.7	9.3	9.4	4.5	6.5	6.2
			(Changes in percent of initial stock of M3)				
Foreign assets (net)	3.4	4.2	-1.5	4.0	-3.1	1.2	3.9
Domestic credit	18.2	16.9	10.5	16.5	15.9	11.2	5.6
Credit to the government (net)	-0.5	3.6	-0.6	5.5	6.4	-0.6	-1.8
Credit to the economy	18.7	13.2	11.0	11.0	9.5	11.8	7.4
Other items (net)	-7.7	-6.8	-3.0	-2.0	0.5	-1.0	-1.7
Memorandum items:							
Velocity (GDP/M2)	2.18	2.06	2.11	1.93	1.83	1.79	1.78
Velocity (GDP/M3)	1.98	1.90	1.94	1.79	1.71	1.65	1.63
Velocity (GDP/M4)	1.53	1.54	1.52	1.52	1.57	1.59	1.60
Multiplier (M2/M0)	3.87	4.15	4.91	4.51	5.39	5.08	…
GDP (in millions of dinars)	19,066	20,898	22,581	24,672	26,677	28,779	30,637
Nominal GDP growth (in percent)	11.8	9.6	8.0	9.3	8.1	7.9	6.5

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

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

Table 6. Tunisia: Commercial Banking System—Performance Indicators, 1995–2001

	1995	1996	1997	1998	1999	2000	Prel. 2001 1/
Average return on assets							
Commercial banks	0.8	0.9	0.8	1.2	1.2	1.2	1.1
Private banks	1.0	1.1	0.9	1.4	1.4	1.5	1.4
Public banks	0.7	0.7	0.7	1.0	1.0	1.2	0.9
Development banks	1.3	1.4	1.4	1.6	2.1	2.9	2.8
Average return on equity							
Commercial banks	11.4	12.3	11.8	12.8	12.8	13.7	12.7
Private banks	14.2	16.0	12.3	13.2	12.7	14.9	14.3
Public banks	11.3	11.7	13.1	13.8	13.3	12.4	10.7
Development banks	4.1	4.2	4.1	4.7	6.1	4.8	4.7
Capital adequacy ratio 2/							
Commercial banks	4.6	5.1	6.3	11.7	11.6	13.3	10.8
Private banks	10.5	9.4	6.8	8.9	10.3	11.5	10.4
Public banks	2.2	3.4	5.9	14.6	12.8	15	11.5
Development banks	32.6	30.8	33.3	36.3	39.1	74.6	66.1
Number of banks not respecting minimum capital adequacy ratio							
Commercial banks	5	5	3	2	1	1	1
Private banks	1	1	1	1	0	0	1
Public banks	4	4	2	1	1	1	0
Development banks	0	0	0	0	0	0	0
Problem loans/total commitments 3/	34.8	31.5	29.9	26.4	25.9	23.6	21.4
Commercial banks	30.8	25.1	23.0	19.5	18.8	21.6	19.5
Private banks	18:2	17.0	19.4	19.4	18.0	15.3	15.9
Public banks	36.8	29.3	25.8	19.6	19.5	26.8	23.6
Development banks	56.7	64.2	67.0	64.3	65.8	54.6	52.5
Provisions/problem loans	33.6	44.0	47.0	53.7	52.7	50.3	48.2
Commercial banks	32.0	46.7	50.4	59.7	58.5	49.2	46.8
Development banks	38.5	38.6	40.6	43.7	43.3	56.7	56.7
Unprovisioned problem loans/total capital							
Commercial banks	166.6	157.7	139.1	94.3	85.6	112.2	107.7
Development banks	110.8	134.4	131.3	123.4	123.5	42.4	43.8
Memorandum items:							
Total credit to the economy/GDP	67.1	63.2	62.7	63.8	63.9	64.3	66.1
Problem loans/GDP	29.3	24.9	23.9	21.4	20.5	18.6	16.7

Source: Tunisian authorities.

1/ Starting in 2001, UIB and BFT are included in private commercial banks. Excluding BCMA, which is being liquidated.
2/ Risk weighted. Averages weighted by banks' capital (fonds propres nets).
3/ Excluding BTS.

Table 7. Tunisia: Indicators of External Vulnerability, 1997–2002

	1997	1998	1999	2000	Est. 2001	Proj. 2002
Balance of payments						
Exports (percent change, 12-month basis in U.S. dollars)	0.7	3.1	2.3	-0.4	13.1	1.5
Imports (percent change, 12-month basis in U.S. dollars)	3.2	5.0	1.5	1.0	11.0	1.3
Exports of goods, f.o.b. (volume percent change)	10.1	6.3	6.7	7.3	15.7	3.7
Imports of goods, f.o.b. (volume percent change)	8.7	5.4	5.8	6.5	13.6	2.9
Terms of trade (percent change, 12 months basis)	-3.6	-2.7	0.0	-2.2	0.1	-0.6
Trade balance (in percent of GDP)	-10.3	-10.9	-10.3	-11.5	-11.8	-11.5
Current account balance (in percent of GDP)	-3.1	-3.4	-2.1	-4.2	-4.2	-4.6
Capital and financial account balance (in percent of GDP)	4.2	2.4	4.4	2.4	5.3	6.7
Short-term foreign assets and liabilities of the banking and corporate sector						
Gross official reserves (in billions of US$)	2.0	1.9	2.3	1.8	2.0	2.4
Gross official reserves (in months of imports goods, cif)	3.0	2.7	3.2	2.6	2.5	3.0
Central bank short-term foreign liabilities (in billions of US$)	0.2	0.2	0.1	0.2	0.2	0.1
Short-term foreign assets of financial, corporate sectors (in billions of US$) 1/	0.6	0.7	0.6	0.7	0.5	0.5
Short-term foreign liabilities of financial, corporate sectors (in billions of US$) 1/	1.2	1.2	1.5	1.5	1.4	1.5
External debt and debt service						
External debt (in billions of US$)	11.1	11.6	11.8	11.5	11.8	12.3
Medium and long-term public debt (in billions of US$)	9.6	10.0	10.3	9.9	10.2	10.6
Short-term debt (in billions of US$)	1.5	1.6	1.6	1.6	1.6	1.7
Total external debt /GDP (percent)	60.7	56.8	59.7	59.6	60.2	60.1
Medium and long-term public debt/GDP (in percent)	52.8	48.8	52.2	51.5	52.3	51.8
Short-term debt/GDP (in percent)	7.9	8.0	7.5	8.2	7.9	8.3
Total short term external debt/reserves (percent) 2/	73.9	84.4	67.1	86.2	79.0	70.6
Short term debt including current amortization/reserves (percent)	121.8	140.8	109.5	159.9	126.0	115.2
Debt service ratio (debt service as percent of exports GNFS)	19.4	19.2	18.5	22.6	15.6	16.7
External interest payments (as percent of exports GNFS)	6.6	6.4	6.1	6.0	5.2	5.2
External amortization payments (as percent of exports GNFS)	12.9	12.8	12.4	16.5	10.5	11.6
Exchange rate (per US$, period average)	1.11	1.14	1.19	1.37	1.44	...
REER appreciation (+, percent change 12 months basis)	-0.1	-0.1	1.0	-0.6	-2.5	...
Financial market indicators						
Stock market index 3/	...	917	1,193	1,443	1,267	...
Foreign currency debt rating 4/	BBB-	BBB-	BBB-	BBB	BBB	...
Spread of benchmark bonds (basis points, end of period)	140-180	470-530	250	130	170	...

Sources: Tunisian authorities, and Fund staff estimates.

1/ Excludes Monetary Authorities. Refers to financial assets and liabilities only.
2/ Short-term defined as 1 year and less.
3/ TUNINDEX. (1000 = 4/1/1998).
4/ S&P long-term foreign currency rating.

Table 8. Tunisia: Medium-Term Growth Scenario, 2001-07

	2001	2002	2003	2004	2005	2006	2007
			(In percent)				
Real GDP growth	5.0	3.8	6.4	6.1	5.8	6.0	6.0
Agriculture 1/	-1.5	-5.0	13.0	6.0	4.5	3.5	3.5
Nonagriculture	6.0	5.0	5.5	6.1	6.0	6.3	6.3
Unemployment rate	15.0	14.5	14.2	13.9	13.6	13.3	13.0
Inflation	1.9	3.4	3.0	2.9	2.7	2.7	2.7
Real export growth 2/	12.9	1.1	8.4	6.9	6.2	6.6	6.6
			(In percent of GDP)				
Gross national savings	23.3	22.5	23.9	24.7	25.0	25.6	25.7
Central government	5.3	6.0	6.3	6.5	6.6	6.8	6.9
Rest of the economy	17.9	16.5	17.7	18.3	18.4	18.8	18.7
Gross investment	27.5	27.1	27.7	27.8	28.0	28.6	28.6
Central government	4.6	4.2	4.5	4.4	4.3	4.2	4.1
Rest of the economy	22.9	22.9	23.2	23.4	23.7	24.4	24.5
Savings-investment gap	-4.2	-4.6	-3.8	-3.1	-3.0	-3.0	-2.9
Central government	0.7	1.8	1.8	2.1	2.3	2.6	2.8
Rest of the economy	-4.9	-6.4	-5.5	-5.1	-5.3	-5.6	-5.8
Memorandum items:							
Balance of the central government 3/	-3.2	-2.5	-2.3	-2.1	-1.9	-1.8	-1.6
External current account	-4.2	-4.6	-3.8	-3.1	-3.0	-3.0	-2.9
Gross fixed capital formation	26.1	26.3	27.1	27.7	27.9	28.6	28.6

Source: IMF staff estimates from 2001.

1/ Based on average growth of agricultural output from 2001 onwards.
2/ Goods and nonfactor services.
3/ Excludes privatization proceeds and social security.

Table 9. Tunisia: Balance of Payments, 2000-2007

(In millions of U.S. dollars)

		Est.	Projections					
	2000	2001	2002	2003	2004	2005	2006	2007
Current account	-814	-844	-944	-839	-741	-767	-832	-866
Trade balance	-2,246	-2,366	-2,378	-2,463	-2,579	-2,785	-3,036	-3,323
Exports	5,840	6,606	6,706	7,405	8,024	8,652	9,361	10,149
Energy	706	610	524	652	624	605	616	627
Non-energy	5,134	5,996	6,181	6,753	7,400	8,047	8,745	9,522
o/w nonfood	4618	5454	5691	6174	6761	7351	7988	8698
Imports	-8,086	-8,971	-9,084	-9,868	-10,603	-11,437	-12,397	-13,472
Energy	-874	-885	-706	-860	-904	-977	-1,084	-1,204
Non-energy	-7,212	-8,086	-8,378	-9,009	-9,699	-10,460	-11,313	-12,268
o/w nonfood	-7,119	-7,956	-8,193	-8,787	-9,472	-10,234	-11,069	-12,007
Services and Transfers (net)	1,432	1,521	1,434	1,624	1,838	2,018	2,204	2,457
Nonfactor	1,610	1,617	1,404	1,645	1,819	2,008	2,219	2,435
o/w Tourism	1,528	1,629	1,466	1,643	1,767	1,911	2,069	2,220
Factor Services and Transfers (net)	-178	-96	30	-21	19	10	-15	21
o/w Workers' remittances	796	851	881	938	1,008	1,085	1,161	1,243
o/w Interest payments on external debt	-515	-491	-484	-517	-574	-631	-698	-732
Capital and financial account	463	1,066	1,385	1,029	931	983	1,082	1,145
Excluding grants	455	1,011	1,284	929	833	885	984	1,049
Capital account	3	51	94	93	92	91	91	90
Financial account	460	1,015	1,291	936	839	892	991	1,055
Direct foreign investment (net)	731	420	945	445	465	485	506	530
Medium and long term loans (net)	223	680	397	525	407	439	518	558
Disbursement	1,597	1,639	1,486	1,655	1,703	1,669	1,859	1,916
Amortization	-1,374	-959	-1,089	-1,131	-1,297	-1,229	-1,341	-1,358
Short term capital	-348	-50	-50	-33	-33	-33	-32	-32
Errors and omissions	-145	-35	0	0	0	0	0	0
Overall balance	-351	222	441	190	190	216	250	279
Changes in gross reserves 1/	465	-154	-431	-192	-194	-220	-253	-284
Use of IMF resources	40	31	0	0	0	0	0	0
Other assets, net (increase -)	425	-185	-431	-192	-194	-220	-253	-284
Memorandum items:								
Current account balance/GDP (in percent)	-4.2	-4.2	-4.6	-3.8	-3.1	-3.0	-3.0	-2.9
Reserves (in billions of US$)	1.8	2.0	2.4	2.6	2.8	3.0	3.3	3.6
Reserves in months of imports	2.6	2.5	3.0	3.0	3.0	3.0	3.0	3.0
External medium-and long-term debt (in billions of US$)	9.9	10.2	10.6	11.2	11.6	12.1	12.7	13.3
External medium-and long-term debt/GDP (in percent)	51.5	52.3	51.8	50.4	48.7	47.2	45.9	44.7
External Short-term debt (in billions of US$)	1.6	1.6	1.7	1.9	2.0	2.2	2.3	2.5
External short-term debt/GDP (in percent)	8.2	7.9	8.3	8.4	8.4	8.4	8.5	8.6
Debt Service Ratio (as percent of exports GNFS, incl IMF)	22.6	15.6	16.7	15.8	16.5	15.2	15.3	14.5
Real goods export growth (in percent)	7.3	15.7	3.7	8.4	7.2	6.1	6.6	6.8
Non-energy	6.3	19.0	3.4	7.1	8.2	7.3	7.2	7.4
Real goods import growth (in percent)	6.5	13.6	2.9	9.3	6.7	6.5	7.2	7.4
Non-energy	7.4	13.6	3.3	8.1	6.3	6.4	6.8	7.0

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

1/ Differs from the overall balance because of valuation effects.

Table 10. Tunisia: Basic Social and Demographic Indicators, 1980–99

	1980	1985	1994	1999	MENA Countries 1999	All Lower Middle Income Countries 1999
Population characteristics						
Total population (in millions)	6.4	7.3	8.8	9.5	291	2,094
Urban population (in percent of total population)	52	54	61	65	58	43
Birth rate (per thousand)	35	29 1/	23	17	27 8/	20 8/
Death rate (per thousand)	9	7 1/	6	6	7 8/	9 8/
Life expectancy at birth (years)	62	66 1/	71	73	68	69
Population growth (in percent)	2.7	3.0	1.7	1.3	2.0	1.1
Income and wages						
GDP per capita (in 1990 dinars)	1,215 2/	1,287	1,449	1,736	...	...
GDP per capita (in current dinars)	635 2/	966	1,791	2,609	...	...
GDP per capita at current prices (in US$)	1,286 2/	1,140	1,771	2,196	2,060	1,200
Minimum wage in the nonagricultural sector (SMIG in current dinars per hour)	0.30 2/	0.46	0.73	0.89	...	...
Poverty incidence (headcount index, in percent of households)	13	8	6 3/	4 9/	...	...
Health						
Infant mortality (per thousand live births)	69	52 1/	32	24	44	32
Population per physician	3,694	2,170 4/	1,754	1,284	4,235 5/	4,287 5/
Education						
Literacy rate (in percent)	45	53	64	70	63	86
Of which:						
Female	31	39	52	59	52	83
Primary enrollment (gross, in percent of school age population)	102	115	117	...	95	114
Secondary enrollment (gross, in percent of school age population)	27	39	57	...	64 6/	67 3/
Pupils per teacher (primary school)	39	32	25	...	26 6/	25 7/
Labor force						
Total labor force (in millions)	2.2	2.5	3.3	3.7	93.8 8/	385.6 8/
Unemployment rate (in percent)	12.9	16.1	15.6	15.8	...	...

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

1/ Data for 1987.
2/ Data for 1981.
3/ Data for 1995.
4/ Data for 1986.
5/ Data for 1981.
6/ Data for 1996.
7/ Data for 1993.
8/ Data for 1998
9/ Data for 2000.

TUNISIA: SUMMARY OF EXISTING AML/CFT FRAMEWORK

The authorities responded to a questionnaire on money laundering and the financing of terrorism for the Article IV consultation. They noted that, although Tunisia does not have specific legislation against money laundering, existing laws and regulations, such as Law 92-52 against narcotics trafficking, incorporate provisions that would contribute to combat money laundering. They indicated that Tunisia has ratified the Vienna Convention of December 19, 1988, against illegal trafficking in drugs and psychotropic substances, as well as the International Convention Against Terrorism of December 9, 1999. However, the financing of terrorism is not specifically defined in existing legislation. Authorities said that the Ministries of Justice, Interior, and Finance are collaborating to draft specific legislation against money laundering and the financing of terrorism. Since there is no legislation on AML/CFT, supervisors of financial institutions do not have specific regulatory requirements and enforcement powers related to such activities.

Law 92-52 against drug trafficking provides a framework to fight money laundering associated with those activities. Under Article 30 of the law, a money laundering infraction would be committed by "anyone who, by fraudulent means or by providing false information, has aided or abetted the perpetrator of offenses covered by Law 92-52 in the transfer of the proceeds in Tunisia, offered him his services or procured facilities enabling him to invest or conceal such funds, even if the various acts were carried out in different countries. The attempt is also punishable." Crimes covered by Law 92-52 under Article 2 include all activities that would facilitate drug trafficking. Since Law 92-52 applies to anyone who aids or facilitates these operations, it also includes financial institutions. Police officers and agents assigned to investigate and report violations of the narcotics law are authorized to monitor its enforcement.

Financial sector regulations provide for know-your-customer rules. Tunisia does not recognize numbered accounts and BCT circulars to banks require identifing bank account owners and individuals initiating transactions on those accounts. Banks are required to keep information on their customers up to date. Credit institutions must retain all documents supporting operations with customers for a period of ten years. Credit institutions are also required to note the identity of anyone who makes a deposit in an account that is not his own (Memorandum to Banks, No. 2001-04 of February 16, 2001). Foreign banknotes brought into Tunisia by travelers may be deposited in a bank account only upon presentation of a customs declaration. In addition to the amount of foreign exchange, this declaration would include the identity, nationality, address of the depositor, and date of entry into the country (Circular 94-13 of September 7, 1994). Financial intermediaries must keep information on the identity of all investors in foreign exchange including their nationality (Circular 93-05 of April 5, 1993).

Financial institutions may perform operations without verifying the identity of the ultimate beneficiary in the case of transactions with institutions abroad. However, the exchange regulations require the presentation of supporting documents for the operations (invoices, contracts, foreign trade certificate, etc.). Otherwise, authorization from the central bank is required. More generally, the authorities noted that a financial institution at which a transaction is completed is also required to verify the identity of the ultimate beneficiary.

There is no obligation for banks to report suspicious operations to the police, the courts, or a specialized agency. There are no regulations or guidelines that have been issued to financial institutions regarding the recognition of unusual or suspicious transactions, including those related to the financing of terrorism. In practice, banks verbally report any suspicious operation to the BCT, which will notify the Economic Enforcement Agency (*Brigade Economique*) if necessary.

To ensure that financial institutions are not themselves set up by criminals, financial sector legislation requires due diligence on the owners or prospective owners of financial institutions. Engaging in the activities of a credit institution is subject to authorization under Law 2001-65 of July 10, 2001 for onshore banks and Law 85-108 of December 6, 1985 for offshore financial institutions working primarily with nonresidents. Authorization is granted by decision of the Minister of Finance, acting on a report from the Central Bank of Tunisia that includes all necessary data and information pertaining to the institution's planned activities, the technical and financial resources to be invested, the identity of the investors and their backers, as well as the moral integrity of the officers. Also subject to authorization is any acquisition of the capital shares of a credit institution likely to confer control of the institution and, in all cases, any operation resulting in the acquisition of 10 percent or more of the voting rights.

The application of the provisions of the laws on the moral integrity of major shareholders, directors, and officers of financial institutions provides for a variety of potential sources of information. The monetary authorities have the option, whenever there is any doubt as to the moral integrity of applicants or the source of funds, to check with the following sources: local office of the national police; main international banks established in the country of origin of the institution or of the individual requesting authorization; foreign supervisory authorities of the institution; financial institutions related in any way to the applicant; financial institutions in which the directors or managers already hold a position.

TUNISIA: FUND RELATIONS

(As of March 31, 2002)

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

II. **General Resources Account:**	SDR Million	Percent of Quota
Quota	286.50	100.0
Fund holdings of currency	266.34	92.96
Reserve position in Fund	20.17	7.04

III. **SDR Department:**	SDR Million	Percent of Allocation
Net cumulative allocation	34.24	100.0
Holdings	1.21	3.52

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):

	Overdue	Forthcoming				
	11/30/2001	2002	2003	2004	2005	2006
Charges/Interest		0.6	0.8	0.8	0.8	0.8
Total		0.6	0.8	0.8	0.8	0.8

Exchange Rate Arrangements and Exchange System

Tunisia accepted the obligations of Article VIII, Sections 2, 3, and 4 effective January 6, 1993. Tunisia maintains certain exchange 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). A system for covering exchange risks has been established for development banks. This mechanism is self financed by contributions from the central bank and financial intermediaries and by a 0.5 percent commission on all overdrafts in the banking system. The mechanism is expected to remain self-financed over time. Tunisia also maintains a multiple currency practice resulting from exchange rate guarantees extended prior to August 1988 to development banks, which will expire after the existing commitments under the guarantee scheme have been paid.

The Central Bank of Tunisia sets the daily official exchange rate in the context of its policy of generally keeping constant the real effective exchange rate. More recently, it has incorporated a broader range of performance indicators, including market share, in an effort to maintain the competitiveness of Tunisian producers. This has resulted in a slight depreciation of the real exchange rate since 2000. Since March 1, 1994, the market rates have been determined in an interbank foreign exchange market. On April 17, 2002, the interbank rate of the dinar vis-à-vis the U.S. dollar was US$1=TD 1.4850, equivalent to SDR 1=TD 1.8681.

Article IV consultation

Tunisia is on the 12-month cycle. The last discussions of the Article IV consultation were held in Tunis from October 18 to November 1, 2000 and the consultation was concluded by the Executive Board on February 5, 2001.

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 the *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.

Resident Representative: None.

TUNISIA: RELATIONS WITH THE WORLD BANK GROUP

(As of January 21, 2002)

Since 1962, the World Bank has committed ten International Development Agency (IDA) credits amounting to US$75 million (net of cancellations), and 189 International Bank for Reconstruction and Development (IBRD) loans, which represent 115 projects, amounting to US$4,625 million (net of cancellations), to Tunisia.

As of March 31, 2002, the sector shares of the Bank Group commitments were as follows: agriculture and environment (22 percent), industry, mining, energy, and oil and gas (8 percent), transport (10 percent), water supply and sanitation (8 percent), urban development (7 percent), education, health, and nutrition (15 percent), financial sector and private sector development (16 percent), economic policy/public sector management (8 percent), and multi-sector loans (6 percent).

Bank lending at first emphasized support for long-term investment in infrastructure, social sector financing, and industrial financing. More recently, Bank lending increasingly supported policy reforms at the sector and macroeconomic levels. Recent loans have included an Education Quality Improvement Project and a Water Sector Investment Loan in FY00; a Transport Sector Project, a Cultural Heritage Project and an Agriculture Support Services Project in FY01. In FY02, an adjustment operation has been approved by the Board of Directors (third Economic Competitiveness Adjustment Loan -ECAL III).

The second tranche of the second Economic Competitiveness Adjustment Loan (ECAL II) was originally scheduled for disbursement in FY00; however, delays in implementing key policy measures in banking sector liberalization and in the regularization of NPLs of the public enterprises resulted in disbursement in March 2001.

ECAL III was approved by the Executive Board on December 20, 2001, for US$252.5 million, with parallel financing from the EU and the African Development Bank. The ECAL III supports the government's Five Year Plan (2002-06), focusing on sub-sectors within the framework of an acceleration of structural policies to increase investment and employment creation, while maintaining a sound macroeconomic framework and preserving social stability. The first tranche of the loan (US$130 million) was disbursed on December 27, 2001.

The Bank's program in Tunisia during the current Country Assistance Strategy (CAS) period (FY01-03) centers on the following:

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

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

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

Tunisia: World Bank Loans and Debt Service, 1995 - 2002 (Fiscal Years)

(In millions of U.S. dollars)

	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02 1/
Commitments	272.8	98.7	241.5	222.0	194.0	202.0	75.9	252.5
Investment projects	272.8	98.7	166.5	222.0	35.0	202.0	75.9	0.0
Adjustment loans	0.0	0.0	75.0	0.0	159.0	0.0	0.0	252.5
Disbursements	209.3	141.6	202.8	132.7	208.6	147.1	174.6	204.9
Investment projects	127.2	140.5	165.3	100.3	137.3	147.1	112.0	75.0
Adjustment loans	82.1	1.1	37.5	32.4	71.3	0.0	62.6	129.9
Total debt service	327.2	323.4	283.1	277.5	270.6	246.5	223.1	178.2
Amortization	199.3	198.7	174.9	180.9	175.9	163.1	146.3	117.2
Interest and charges	127.9	124.7	108.2	96.6	94.7	83.4	76.8	61.0

Source: World Bank Loan Kiosk.

1/ As of March 31, 2002.

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. *International Finance Statistics* (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, Government finance statistics data up to 2000 are published in the *Government Finance Statistics Yearbook* 2001. Data cover consolidated central government. Tunisia does not report monthly or quarterly data for publication in IFS. More detailed data regarding the financial performance of public enterprises should be provided.

Balance of payments

4. Balance of payments statistics are generally adequate for surveillance, although greater detail on the financial account and external debt would be desirable. Efforts have been made to collect data on short-term external debt.

Money and banking

5. Money and banking statistics are timely and provide policymakers with sufficient information for most purposes. The authorities are actively working to further develop the indicators used to measure financial stability.

TUNISIA: CORE STATISTICAL INDICATORS

As of April 30, 2002

	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	04/18/02	March 02	Feb 02	Feb 02	Feb 02	04/18/02	Mar/ 02	Q4/01	Q4/01	2001	Q4/01	Q4/01
Date received	04/22/02	Apr/02	Mar/02	Mar/02	Mar/02	04/22/02	Apr/02	Mar/02	Mar/02	March	Mar/02	Mar/02
Frequency of data	D	M	M	M	M	D	M	Q	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/ Electronic	Fax/ Electronic	Fax/ Electronic	Fax/ Electronic	Fax/ Electronic	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

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

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IMF Concludes 2002 Article IV Consultation with Tunisia

On June 5, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tunisia.[1]

Background

Economic growth averaged 5.5 percent during the period 1996-2001, evidence that gradual liberalization of the economy has produced results in terms of productivity, growth, and economic diversification. Real GDP grew by 5 percent in 2001 compared to 4.7 percent in 2000, despite a contraction in agricultural output of 1.5 percent caused by a third consecutive year of drought. Activity was particularly robust in the mechanical-electrical industry, which grew by 14 percent, and the textile industry, which expanded by 12 percent. However, unemployment remains high at about 15 percent.

The authorities now face the challenge of reining in strong demand which has put pressures on the external position and lowered foreign exchange reserves. While exports continued to be an engine of growth, domestic demand grew by 5.2 percent, slightly ahead of GDP growth. Thus, the savings-investment gap did not improve in 2001 and the external current account deficit remained unchanged at 4.2 percent of GDP in 2001. External reserve coverage fell to an average level of 2.2 months worth of imports during the year, although the first disbursement of the World Bank's Economic Competitiveness Adjustment Loan in December helped raise foreign exchange reserves to 2.5 months worth of imports, unchanged from end-2000.

Fiscal policy maintained a broadly neutral stance in 2001: the deficit of the central government (excluding grants and privatization receipts) was 3.5 percent of GDP, close to the budget

[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.

target for 2001. The central bank tightened its monetary stance in response to the deteriorating external position and the expansion of liquidity aggregates during the year. Nevertheless, credit to the private sector expanded by more than 10 percent from 8 percent in 2000, fueling strong economic activity and higher imports, although this had little effect on inflation. CPI inflation dropped to 1.9 percent, its lowest rate since 1972 as the increase in private sector credit flowed into higher imports, administered prices (which represent one third of the index), were raised only slightly, and the reduction in tariffs on manufactured goods helped keep prices down.

The authorities followed a more flexible approach to exchange rate policy, allowing the average real effective exchange rate to depreciate by 0.6 percent in 2000 and by 2.5 percent in 2001. After increasing significantly less than for other emerging markets, spreads on secondary market debt have now returned to the levels prevailing before September 11. Standard and Poor's reconfirmed its BBB rating on Tunisian foreign currency long-term sovereign credit, and in May 2001, Fitch upgraded Tunisia's foreign currency debt rating from BBB- to BBB.

Progress in structural reform was concentrated in the telecommunications and financial sectors and the second GSM license was sold in March 2002. While some headway was made at restructuring and modernizing the financial sector, increasing bank efficiency, and improving loan recovery, the banking system needs to be put on a more commercial footing. Tariff reduction under the Association Agreement with the European Union moved ahead broadly as scheduled and Tunisia's simple average tariff rate declined from 35.9 percent in 2000 to 28.3 percent in 2001. However, the economy remains highly protected with a rating of 8 (10 is most restrictive) under the IMF's trade restrictiveness index. Privatization results fell short of objectives in 2001: of the 41 enterprises scheduled for privatization, only about 15 small companies were sold. The government's industrial restructuring program "mise à niveau" has by most measures contributed to upgrading the competitiveness of domestic producers.

The past years of robust economic growth are likely to be cut short in 2002 by the impact of the events of September 11, 2001 on tourism flows, and by a further drop in agricultural production as a result of continued drought. These two factors are likely to weigh on the external position and could push the external current account deficit higher in 2002 if macroeconomic policies are not adjusted.

The authorities continue to increase the transparency of their policies: Tunisia subscribed to the Special Data Dissemination Standard (SDDS) in June, 2001 and published the 2000 Article IV Staff Report, the Preliminary Conclusions of the 2002 Article IV mission and the Observations of the 2001 Interim Consultation Mission. The authorities intend to publish the 2002 Article IV Staff Report, and the Financial Sector Stability Assessment (FSSA).

Executive Board Assessment

Directors commended Tunisia for its strong economic performance and social achievements, which they attributed to well-coordinated macroeconomic, structural, and social policies implemented over the past several years. These policies had borne fruit in higher productivity and economic growth, a more diversified economy, and an improved credit rating and easier access to international capital markets. Directors observed that there is scope to further improve on this performance in the future by accelerating the pace of liberalization and transition to a fully market-driven and open economy. In this respect, they stressed the importance of more comprehensive trade and price liberalization measures and a reduction in the role of the state in the economy.

Directors noted that strong domestic demand and a less favorable external environment have put pressure on prices and the external balance and have lowered foreign exchange reserves. With Tunisia's saving-investment gap rising, Directors endorsed the authorities' commitment to tighten monetary and fiscal policies in order to maintain macroeconomic stability, while noting that the measures in place so far might not sufficiently strengthen the external position. They welcomed the information that the authorities had begun to implement some parts of the additional expenditure measures that they had formulated as a contingency. Most Directors, however, advised proceeding promptly with further adjustment measures to contain pressures on the external current account, particularly in view of the likely adverse impact of September 11 on tourism, and the adverse effects of continued drought on agricultural production.

Directors also urged the authorities to address existing fiscal rigidities, particularly the high wage bill. Indeed, they believed that more fundamental reforms are necessary to lower the wage bill and improve the efficiency of the civil service. A number of Directors also recommended phasing out price subsidies as soon as possible given their inefficiency and distortion of market signals. The authorities' plan to reconsider tax holidays was welcomed, and several Directors urged further rationalizing these. With respect to medium-term challenges, Directors commended the authorities for undertaking a comprehensive review of the social security system and for taking measures to ensure its near-term viability.

Directors noted with satisfaction the drop in inflation in 2001, and commended the authorities for their increasingly active stance in monetary management. In particular, Directors welcomed the increased reliance on interest rate signals in the conduct of monetary policy. In view of the changing policy environment—reflecting increased economic openness and liberalization of trade and capital flows—Directors encouraged the authorities to establish a fully transparent monetary policy framework. They supported the adoption of price stability as the central bank's main objective, while cautioning that the use of a monetary aggregate as an intermediate target would require development of the ability to accurately forecast money demand.

Directors noted that Tunisia's approach to exchange rate policy had served the economy well. In the context of the changing policy environment and a more market-driven monetary policy, however, Directors believed it would be appropriate to gradually reduce intervention in the foreign exchange market, after putting in place a sound and transparent monetary framework. They noted that monetary policy should, over time, become the anchor for price and exchange rate expectations.

Directors noted the importance of ensuring the continuing competitiveness of the Tunisian economy. They welcomed the authorities' recent use of a broader range of indicators to gauge the competitive position of producers. Directors took note of the staff's finding that the current level of the exchange rate appeared broadly appropriate, and stressed that exchange rate depreciation should not be used as a substitute for the fiscal and monetary adjustment required to bring domestic demand under control.

Directors welcomed the authorities' plans to liberalize external capital flows, while agreeing that it would be most important to prepare the groundwork prudently before moving to an open capital account. Key priorities in this regard would be to establish a transparent and soundly-based framework for monetary policy that would anchor inflationary expectations; to implement a flexible exchange rate regime; and to further strengthen the banking system and address budgetary rigidities. Directors also endorsed the staff's preliminary recommendations for diversifying the sources of external financing.

Recognizing that the authorities' overriding policy objective over the medium term is to lower unemployment, Directors underscored the importance of intensifying structural reforms and making further progress in fiscal consolidation particularly in view of the authorities investment and savings goals. On the structural front, they stressed that further reforms are required in the following areas: the financial sector, trade liberalization, and privatization.

Directors welcomed the steps taken toward strengthening the banking system, while stressing the importance of further action to place it on solid ground and a more commercial footing. They viewed this transformation as essential for the success of the proposed reforms in monetary and exchange rate policy, and also as a precondition for the effective application of banking supervision and prudential regulation. In this respect, Directors encouraged the authorities to fully implement the recommendations contained in the FSSA report.

While Tunisia made some progress in reducing import tariffs in 2001, Directors observed that the economy remains highly protected. They emphasized the importance of moving forward in all areas of the Association Agreement with the European Union, namely trade in services, competition rules, and the treatment of state monopolies engaged in commercial activities. In addition, Directors stressed that reduction in tariffs with the EU should be accompanied by further tariff reduction on products from non-EU countries and by harmonization of the array of different bilateral trade accords in order to avoid trade distortion.

Directors noted the recent progress in liberalizing the telecom sector with the sale of a second GSM license. Nevertheless, they urged the authorities to intensify privatization efforts. They welcomed the work underway in collaboration with the World Bank in promoting further privatization, improving the private investment climate, and reviewing labor-market trends and government policies in an effort to identify impediments to employment growth. A number of Directors pointed to a possible relationship between labor market regulations and the high rate of unemployment, and suggested that additional steps be taken to eliminate rigidities, including introducing greater flexibility into the wage-setting process and adapting labor market regulations to the needs of a more flexible labor market.

Directors commended the authorities' commitment to transparency, including the publication of the staff report; and they welcomed the substantial improvements in the quality and dissemination of data as well as the subscription to the SDDS in June 2001. Directors urged the authorities to continue this positive performance and to address deficiencies in the reporting of data on non-financial public enterprises and labor market and wage developments.

Directors took note of the authorities' participation in the Fund's work on anti-money laundering and combating the financing of terrorism and welcomed the initiatives already launched by Tunisia in this area. They urged the authorities to establish a legislative framework unifying these measures as soon as possible.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2002 Article IV Consultation with Tunisia is also available.

Tunisia: Selected Economic Indicators

	1997	1998	1999	2000	Est. 2001	Proj. 2002
	(Annual percent change; unless otherwise indicated)					
Production and income						
Real GDP	5.4	4.8	6.1	4.7	5.0	3.8
GDP deflator	4.0	3.0	3.1	3.3	2.7	2.6
Consumer price index (CPI), average	3.7	3.1	2.7	3.0	1.9	3.4
Gross national savings (in percent of GDP)	23.3	23.5	24.2	23.1	23.3	22.5
Gross investment (in percent of GDP)	26.4	26.9	26.3	27.3	27.5	27.1
External sector (percent change)						
Exports of goods, f.o.b. (in US$)	0.7	3.1	2.3	-0.4	13.1	1.5
Imports of goods, f.o.b. (in US$)	3.2	5.0	1.5	1.0	11.0	1.3
Trade balance (in percent of GDP)	-10.3	-10.9	-10.3	-11.5	-11.8	-11.5
Current account, excl. grants (in percent of GDP)	-3.1	-3.4	-2.1	-4.2	-4.2	-4.6
Real effective exchange rate (depreciation -) 1/	-0.1	-0.1	1.0	-0.6	-2.5	...
	(In percent of GDP)					
Consolidated central government 2/						
Revenue, excluding grants	28.4	29.2	29.1	29.3	29.5	29.2
Total expenditure and net lending	32.6	32.0	31.7	32.7	32.3	31.4
Consolidated balance, excl. grants and privatization	-4.2	-2.9	-2.6	-3.4	-2.8	-2.2
Consolidated balance, incl. grants and privatization	-3.8	-0.6	-2.3	-2.0	-2.5	0.6
Central government balance, excl grants and privatization 3/	-4.6	-3.6	-3.9	-3.8	-3.5	-2.8
	(Annual percent change; unless otherwise indicated)					
Money and credit						
Credit to the economy	10.0	8.7	8.5	8.0	10.4	6.6
Broad money (M3)	14.2	6.0	18.6	13.2	11.4	7.8
Liquidity aggregate (M4)	8.7	9.3	9.4	4.5	6.5	6.2
Interest rate (money market rate, in percent)	6.90	6.88	5.88	5.88	6.02	...
Official reserves						
Gross official reserves (in billions of US$, end-period)	1.99	1.87	2.29	1.83	1.98	2.41
In months of imports of goods, c.i.f.	3.0	2.7	3.2	2.6	2.5	3.0
Total external debt (Short, medium and long-term)						
External debt (in percent of GDP)	60.7	56.8	59.7	59.6	60.2	60.1
Debt service ratio (in percent of exports of good and services)	19.4	19.2	18.5	22.6	15.6	16.7

Sources: Data provided by the Tunisian authorities; includes IMF staff projections for 2001 and 2002.

1/ IMF Information Notice System (average).
2/ Includes the social security accounts (CSS), unless otherwise indicated.
3/ Excludes the social security accounts (CSS).