TUNISIA - Briefing/De-briefing Papers 1975-85

#53887

BOX 265 FILE 3

ETRA1 ETR FILES

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E/R
5-100
cc: Mr. Kanesa-Thasan

Office Memorandum

TO : The Acting Managing Director

DATE: August 8, 1985

FROM : A.D. Ouattara

SUBJECT : Tunisia - Back-to-Office Report

Attached please find the back-to-office report of Mr. Bhatia's mission to Tunisia. The report raises no immediate issues for your consideration. It draws to your attention the continued serious financial situation of Tunisia and the growing awareness on the part of the authorities to tackle the problem. They are looking forward to the Fund's technical advice in formulating their objectives and policies for the next Plan (1986-91). The mission has already presented alternative sets of measures to the authorities who have requested that a small staff team return to Tunis in late October when they will be in a position to discuss more fully their medium-term scenario as well as the policies for 1986.

Attachment

cc: The Managing Director (o/r)
Mr. Collins

Office Memorandum

TO : The Acting Managing Director DATE: August 8, 1985

FROM : Rattan J. Bhatia RJB

SUBJECT : Tunisia - 1985 Article IV Consultation Discussions

The 1985 Article IV consultation discussions were held with the authorities in Tunis from July 22 to August 3. 1/ Also, as was envisaged during the June meeting between President Bourguiba and the Managing Director, the mission held discussions on the authorities' preliminary objectives for the next development plan (1986-91) and on a possible policy package for 1986 to redress the growing disequilibria in the balance of payments.

Actual financial developments in 1984 were less favorable than were anticipated and consequently the prospects for 1985 also appear to be more disquietening. While the economic growth performance was satisfactory, financial developments continued to be unfavorable Thus in 1984, real GDP rose by 5.4 percent (4.8 percent in 1983), the external current account deficit increased to an unprecedented high of 10.7 percent of GDP, and the inflation rate accelerated to 8.4 percent despite the wage freeze, and widespread price controls and an increase in consumer subsidies. The overall budget deficit, at 7.5 percent of GDP, was slightly lower than 8.1 percent recorded in 1983 but at the same time the Government appears to have incurred some domestic payments arrears in respect of the subsidized goods. Broad money increased by nearly 12 percent, as total bank credit rose by over 15 percent. To finance the external deficit, the Central Bank drew a part of an external loan contracted on the international financial market and there was a small decline in net external reserves (as against a strong increase in the previous year). The debt service ratio in 1984 jumped by 3.3 percentage points to 19.9 percent of the external current account receipts (gross).

The "Economic Budget" for 1985, which was prepared in late 1984, was based on a more favorable view of the likely developments in 1984, and, therefore, envisaged only limited measures aimed at stabilizing the situation in 1985. Following the results for 1984 and the continuing decline in external reserves in the early months of 1985, the authorities took certain further measures--notably increases in the prices of subsidized commodities (including wheat, flour and bread), continued wage freeze, increases in interest rates, and a gradual depreciation of the real exchange rate which has now eliminated the earlier appreciation of the dinar. In addition, investment expenditures in the budget are being

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1/ The staff team comprised Messrs. Lienert, Dairi, Nord, Miss Abdallah and myself. On the Tunisian side the mission met, among other officials, the Ministers of Finance, Plan, National Economy, Agriculture, and Tourism, and the Governor of the Central Bank of Tunisia.

reduced and incentives to the private sector being revised to discourage capital-intensive projects and imports of equipment. Import controls have been intensified and importers are encouraged to find their own foreign exchange for certain designated purposes.

The mission welcomed the general consensus that appears to have emerged within the Government to undertake corrective measures. It also welcomed the measures introduced recently, with the exception of the intensification of import controls. Nevertheless, and despite a record agricultural crop (21 million tons against a 'normal' crop of 13 million) which is expected to result in a 4 percent growth in GDP in 1985, the overall financial situation remains grave. The external current account deficit is now projected at about D 550 million (8 percent of GDP) necessitating a drawdown of the balance of the US$132 loan contracted in the financial markets in 1984 and a possible loss of about D 100 million (US$125 million) in the external reserves of the Central Bank which at end-June 1985 amounted to about D 200 million, or the equivalent of about one month's imports. The overall (consolidated) budget deficit will also increase to 8 percent of GDP. The authorities stated that they were considering some further measures (e.g. price increases and some increases in taxes) but that by and large their margin of flexibility in the current year was exhausted and that a stronger set of corrective measures must await 1986. They indicated that already for that year, it has been decided to limit the increase in the current expenditures in the budget to 6 percent and to reduce investment expenditures by a further 10 percent. They also plan to move at a faster pace toward the introduction of a generalized VAT.

The mission discussed a possible policy package for 1986 within the context of a medium-term scenario, subject to the constraint that the external debt service ratio will not exceed the present level (20.9 percent) in any of the years of the next Plan (implying an average annual ratio of 20.5 percent). The mission felt that if such a constraint were still to allow an average annual growth rate of GDP of about 3.5 percent, export volume must increase by an average of at least 4 percent annually (after taking into account the projected decline in the net exports of petroleum) and imports by much less, which would be greatly facilitated if appropriate policies in other fields were accompanied by an initial depreciation of the dinar by 10-15 percent (in local currency). To illustrate this point the mission proposed two policy scenarios for 1986 (see attached table) which demonstrated that with the same objectives in respect of the external debt increase and external current account deficit, the authorities would be able to follow less restrictive demand-management policies than without, as it would encourage exports (the mission took a very conservative estimate of the average price elasticity of supply--0.5 against the World Bank's 2.0--and assumed its effects to become fully felt over a three-year period), with the elasticity being only 0.15 for 1986 thereby permitting some import liberalization, wage and employment increase, and even some reconstitution of external reserves.

The authorities received our scenarios favorably and emphasized that they were open to an exchange rate adjustment within the context of a comprehensive program that would assure corresponding policy adjustments in other areas. They said they would be finalizing their medium-term projections for the next Plan, as well as the "Budget Economique" for 1986 towards the end of October and that the mission's projections and recommendations would be given serious consideration. They wished the staff team to return to Tunisia soon after the Annual Meeting to further discuss their draft Budget Economique for 1986, as well as the medium-term objectives before they were finalized. By that time the staff report on the Article IV consultation would have been issued (by September 15) and discussed by the Board (soon after the Annual Meetings). The Governor of the Central Bank of Tunisia envisages some discussions with the staff in Seoul on the staff report.

The mission's overall impression is that the authorities have decided to concentrate on redressing the financial imbalances, even at the short-term cost of employment and reducing investment. They feel that they have a small margin of flexibility which should enable them to avoid "crisis measures" that could jolt the present social balance. However, they are also conscious that they cannot postpone adjustment any further and that they must follow pragmatic policies which embrace politically difficult decisions such as raising subsidized prices and promoting greater liberalization of the economy. In this phase, they are looking to both the Fund and the World Bank for policy advice and assistance.

Attachment

cc: The Managing Director (on return)
Mr. Collins

ASD	LEG
CBD	MED
ETR	PAR
EUR	RES
EXR	SEC
FAD	TRE
GEN	STAT
INST	WHD

Tunisie - Schéma : Politique financière, 1986

Scenario I

1. Taux de change constant en termes réels.

2. Supprimer une partie des restrictions sur les matières premières et semi-produits en les sortant du régime de l'AAI.

3. Limiter le déficit du compte courant de la balance extérieure à D 460 millions.

4. Limiter le recours (brut) à la dette extérieure à D 640 millions. Aucun changement des réserves extérieures nettes.

5. Limiter le déficit budgétaire (consolidé) à D 500 millions, ce qui implique un déficit de D 485 millions dans la Loi des Finances. Limiter le recours au système bancaire à D 50 millions.

6. Augmentation de la masse monétaire (M2) à 10 pour cent.

7. Continuation du gel des salaires. Limiter le nouveau recrutement à 1 pour cent. Supprimer les subventions pour les produits tels que le sucre et l'alimentation du bétail. Relever les prix d'autres produits à une proportion supérieure à ceux implicites dans le scénario II.

8. Introduction d'un "balance of payments test" (les variations trimestrielles des devises de la BCT) pour surveiller la conformité des développements par rapport aux objectifs, et pour prendre des mesures supplémentaires, si nécessaire.

9. Limiter les dépenses en capital et prêts nets à D 848 millions.

Scénario II

1. Ajustement du taux de change 10-15 pourcent.

2. Libéralisation des importations. Supprimer le régime de l'AAI pour les importations de matières premières et semi-produits.

3. Limiter le déficit du compte courant de la balance extérieure à D 460 millions.

4. Limiter le recours (brut) à la dette extérieure à D 680 millions.

5. Limiter le déficit budgétaire (consolidé) à D 500 millions.

6. Augmentation de la masse monétaire (M2) à 12 pour cent.

7. Augmentation générale (moyenne) des salaires de 5 pour cent. Limiter le nouveau recrutement à 2 pour cent des effectifs actuels. Supprimer les subventions pour les produits tels que le sucre et l'alimentation du bétail. Relever les prix d'autres produits en vue de maintenir les subventions unitaires constantes en termes réels.

8. Limiter les dépenses en capital et prêts nets à D 929 millions.

Cleared by DMD and MD [illegible]

Office Memorandum

Mr. Ouattara

P. 15

OK

July 12, 1986

TO: The Acting Managing Director DATE: July 3, 1986

FROM: A.D. Ouattara

SUBJECT: Tunisia--Briefing Paper, Article IV Consultation

Attached for your approval is the briefing paper for the forthcoming Article IV consultation mission. As mentioned in the brief, if requested by the Tunisian authorities, the mission would have preliminary discussions on the possible future use of Fund resources in the credit tranches. Also, information will be gathered for a possible future purchase under the compensatory financing facility. The brief has been cleared by:

Mr. Gondwe (AFR)
Mr. Kanesa-Thasan (ETR)
Mr. Chandavarkar (TRE)
Mr. Kreis (FAD)
Mr. Elizalde (LEG)

An advance team will be departing headquarters this weekend, and Mr. Bhatia's last day in the office will be July 14.

Attachment

cc: Managing Director (on return)
Mr. Brown

Since Tunisia has had serious political difficulties when implementing price increases, I think special attention needs to be given to the modalities of price adjust for particular sensitive goods. Such modalities should facilitate and not delay price adjust.

Moreover, it was intended to have liberalization of prices for all industries considered by the investment agency (API) as sufficiently developed, except when the number of producers is not large enough to ensure competition. For industries that would remain subject to price control during 1986-88 and beyond, the relevant enterprises were to be allowed to adjust their prices on the basis of pre-agreed criteria and after a reasonable notification period, unless the authorities presented a duly justified objection. The mission would urge the authorities to press ahead with this policy. As regards agricultural prices, the mission would emphasize the need for appropriate incentives; in particular, it would be stressed that the authorities not restrain any needed increases in producer prices by their concern regarding consumer prices.

Would we direct or explicit subs for low income groups be part of this adjustment

4. Liberalization of investments

Over the next few years the Government intends to abolish gradually controls on investments that do not request special incentives, in coordination with the liberalization of prices and import trade. This would be accomplished within the framework of a new system of investment incentives that would do away with across-the-board incentives, but would focus on promoting exports, regional development, and technology transfer. It was envisaged that before end-1986 the requirement of prior approval would be abolished for all new small investments valued at less than D 200,000, and for all replacement investments which are not subject to import licensing and do not request any special incentives from the Government. Confirmation of this intention would be

Office Memorandum

TO: The Acting Managing Director DATE: July 3, 1986

FROM: A.D. Ouattara

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cc: Managing Director (on return)
Mr. Brown

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

TUNISIA

Briefing Paper - 1986 Article IV Consultation

Prepared by the African Department and the Exchange and
Trade Relations Department

(In consultation with the Fiscal Affairs,
Legal, and Treasurer's Departments)

Approved by A.D. Ouattara and S. Kanesa-Thasan

July 3, 1986

I. Introduction

A mission comprising Messrs. Bhatia (head-AFR), Rothman (AFR), Dairi (AFR), and Rodlauer (ETR), and Ms. Orraca-Tetteh (secretary- AFR) will visit Tunis for about two weeks beginning July 7, 1986 to conduct the 1986 Article IV consultation discussions. Also, the mission will, if requested by the Tunisian authorities, have preliminary discussions on the possible future use of Fund resources in the credit tranches. Mrs. Meldau-Womack (RES) will join the mission for about one week to gather the necessary information for analysis of a possible future request by Tunisia under the compensatory financing facility. Summaries of Tunisia's relations with the Fund and the World Bank Group, and of the status of statistical issues are provided in the attached appendices.

The last consultation discussions were held in July-August 1985, and the staff report (SM/85/261) was discussed by the Executive Board on November 12, 1985.

II. Background

During the 1970s and early 1980s, Tunisia experienced relatively rapid economic growth, domestic financial stability, and a generally strong balance of payments position, associated largely with buoyant petroleum exports. Beginning in 1982, however, the economic and financial situation has weakened markedly. While exogenous factors such as inadequate rainfall (in 1982-83), a slowdown in world demand, the worsening of economic relations with Libya (an important market for Tunisian exports and for employment of Tunisian labor), and a deterioration in the terms of trade have dampened overall economic activity and export performance, expansionary fiscal, monetary, and incomes policies and an inadequate exchange rate policy have also had a significant adverse impact. This has culminated in a sharp increase in the country's external current account deficit and external indebtedness, a rapid drawdown on foreign reserves, continued reliance on price controls, and intermittent tightening of import and investment controls. More specifically, during the period 1982-85 the annual rate of growth in real gross domestic product (GDP) averaged 3.7 percent, compared with 6.5 percent in 1978-81, and the external current account deficit averaged 8.7 percent of gross national product (GNP), compared with 6.7 percent (Table 1). During 1982-85, the consolidated central government deficit doubled to an average of 7 percent of GNP, associated mainly with a rapid expansion in the wage bill and sharp increases in transfers to households and public enterprises, and in investment outlays. These deficits were financed by continued high levels of

Table 1. Tunisia: Selected Economic and Financial Indicators, 1981-86

	1981	1982	1983	1984	1985	1986 Projections 1/
	(Annual percent changes)					
National income and prices						
GDP at constant prices	6.4	-0.1	4.9	5.5	4.5	--
GDP deflator	10.5	15.0	9.3	6.8	6.3	5.0
Consumer price index	9.0	13.6	9.0	8.6	7.8	7.0
External sector (in SDRs)						
Exports, f.o.b.	13.2	-13.9	-2.9	1.0	-3.6	-22.7
Imports, f.o.b.	15.2	-4.2	-5.6	7.5	-15.8	-6.9
Terms of trade (deterioration -)	5.2	-2.1	-4.5	-2.3	-2.5	-15.9
Nominal effective exchange rate 2/ (depreciation -)	3.0	-2.7	-0.2	-0.2	-1.3	-4.8 3/
Real effective exchange rates 2/						
WPI based (depreciation -)	-0.1	8.0	-0.9	-3.1	0.9	...
CPI based (depreciation -)	-0.9	-1.2	-0.8	-0.4	-0.9	-6.2 3/
Central government consolidated operations						
Revenue	17.9	24.3	12.3	21.8	2.7 4/	1.2
Total expenditure and net lending	17.0	33.3	20.4	16.6	5.6 4/	4.5
Current expenditure	16.0	41.8	20.3	17.1	7.0 4/	8.3
Capital expenditure and net lending	18.8	18.8	20.7	15.6	2.8 4/	-3.7
Money and credit						
Domestic credit	24.3	23.7	19.4	15.4	16.2	...
Government	(16.4)	(20.1)	(15.5)	(27.3)	(22.8)	(...)
Economy	(25.6)	(23.9)	(19.9)	(13.7)	(15.2)	(...)
Money plus quasi-money	19.3	18.9	18.5	11.7	14.4	...
Interest rates						
Discount rate	7.00	7.00	7.00	7.00	9.25	9.25
12- 18-month time deposit	7.00	7.00	7.00	7.00	8.00	8.00
General rediscountable advances	8-8 1/2	8-8 1/2	8-8 1/2	8-8 1/2	9 1/2-10	9 1/2-10
	(Ratios: in percent of GNP unless otherwise specified)					
Government revenue	31.8	34.3	33.6	36.5	34.1 4/	32.9
Total expenditure and net lending	34.3	39.7	41.7	43.3	41.7 4/	41.5
Current expenditure	21.7	26.7	28.0	29.2	28.5 4/	29.4
Capital expenditure and net lending	12.6	13.0	13.7	14.1	13.2 4/	12.1
Central government consolidated deficit (-)	-2.5	-5.4	-8.1	-6.8	-7.6 4/	-8.6
Domestic bank financing	(0.9)	(1.1)	(0.9)	(1.6)	(1.5)	(...)
Gross fixed capital formation	30.8	32.6	30.4	30.2	25.2	24.6
Gross national savings	24.4	21.9	20.8	20.8	19.0	15.8
External current account deficit (-)	-7.7	-9.4	-7.7	-10.9	-6.6	-9.2
External public debt	38.0	41.8	45.3	50.6	46.6	52.7
Debt service/Exports of goods and services plus private transfers	13.6	14.7	16.6	19.5	21.1	24.9
Gross official international reserves (in months of imports, f.o.b.)	1.9	2.4	2.5	1.8	1.0	0.4 (March)
	(In millions of SDRs)					
Overall balance of payments deficit (-)	78	25	-14	-146	-117	-134
Gross official international reserves (at end of period)	467	556	548	421	234	85 (March)
External public debt	2,654	2,974	3,304	3,709	3,825	4,258
	(In millions of dinars)					
GNP at current prices	4,194	4,836	5,546	6,227	6,825	7,168

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

1/ Staff projections based on policies as of mid-June 1986.
2/ Weighted by non-oil trade and tourism flows in 17 partner and competitor countries.
3/ May 1986 over end-1985.
4/ Staff estimates.

foreign borrowing and increasing recourse to domestic sources, including, importantly, the banking system. The average annual increase in domestic credit (19 percent) was about one and one half times that in nominal GNP. The rate of inflation, as measured by the consumer price index, rose to almost 14 percent in 1982 and subsequently moderated to 8-9 percent in 1983-85, partly due to continued reliance on price controls and subsidies. Despite the large-scale foreign borrowing which resulted in an increase in external debt from the equivalent of 38 percent of GNP in 1981 to almost 47 percent in 1985, there was a decline in external reserves from the equivalent of about two months of imports in 1981 to that of one month at end-1985.

In 1985, real growth in GDP was 4.5 percent (5.5 percent in 1984) due mainly to the doubling of value added in agriculture, following a record cereal crop, and a substantial recovery in tourism, despite a decline in production in the hydrocarbon sector for the second consecutive year. The rate of consumer price increase moderated slightly to 7.8 percent, from 8.6 percent in 1984. The government deficit increased to the equivalent of 7.6 percent of GNP (6.8 percent in 1984) with marked decelerations in both revenue and expenditure growth (Table 2). Domestic credit increased again faster than nominal GNP (16 percent compared with 11 percent), and despite a further decline in net foreign assets, broad money rose by 14.4 percent. As a result partly of tightened import and investment controls, the external current account deficit narrowed to the equivalent of 6.6 percent of GNP, compared with almost 11 percent in 1984. Exports (in SDR terms) declined by 3.6 percent, mainly as a result of a continued contraction

Table 2. Tunisia: Consolidated Financial Transactions of the Central Government, 1982-86

	1982	1983	1984	1985 Est.	1986 Proj.
	(In millions of dinars)				
Revenue and grants	1,658	1,863	2,270	2,331	2,358
Oil revenue	330	272	348	390	349
Other	1,328	1,591	1,922	1,941	2,009
Expenditure and net lending	1,919	2,311	2,696	2,847	2,975
Current expenditure	1,290	1,552	1,818	1,944	2,105
Of which: wages and salaries	(482)	(574)	(633)	(700)	(749)
transfers	(509)	(548)	(794)	(809)	(856)
Capital expenditure and net lending	629	759	878	903	870
Overall deficit (-)	-261	-448	-426	-516	-617
Financing	261	448	426	516	617
Foreign (net)	196	284	165	205	...
Domestic (net)	65	164	261	311	...
Banking system	18	50	89	172	...
	(As percent of GNP)				
Memorandum items:					
Revenue and grants	34.3	33.6	36.5	34.1	32.9
Expenditure and net lending	39.7	41.7	43.3	41.7	41.5
Of which : current expenditure	(26.7)	(28.0)	(29.2)	(28.5)	(29.4)
Overall deficit (-)	-5.4	-8.1	-6.8	-7.6	-8.6

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

in energy exports and stagnation in nonenergy exports (owing mainly to a depressed market for phosphates and derivatives) (Table 3). Imports declined by almost 16 percent, because of lower cereal imports, a further tightening of import and investment controls starting in mid-1985, and a cutback in public investment expenditure. Tourism receipts increased by 9 percent, but remained below their peak level in 1981-83, while net transfers turned negative following the expulsion of about 30,000 Tunisian workers from Libya. The improvement in the current account was offset by a narrowing of the capital account surplus, as direct and portfolio investment declined substantially, and loan disbursements were below their 1984 level. As a result, the overall balance of payments recorded a deficit of SDR 117 million. This deficit was financed through a rundown of official foreign reserves, which amounted to SDR 234 million at end-1985, or, as noted above, the equivalent of one month of imports. Also as indicated earlier, external debt outstanding as a ratio to GNP was about 47 percent at end-1985, and the ratio of debt service to exports, services, and private transfers in 1985 was 21.1 percent.

For 1986, real GDP is now projected to remain virtually unchanged from the 1985 level, reflecting declines in agricultural and hydrocarbon production and a weakening in most other sectors. Following unfavorable weather conditions, cereal production is expected to decline by more than half from the exceptional 1985 level.

The consolidated central government deficit was initially projected to decline to 6 percent of GNP (7.6 percent in 1985). This included the effect of increases in taxes and in domestic retail petroleum prices,

Table 3. Tunisia: Balance of Payments and External Debt, 1981-86

(In millions of SDRs)

	1981	1982	1983	1984	1985 Est.	1986 Proj.
Balance of payments						
Exports, f.o.b	2,082.1	1,793.3	1,740.0	1,757.1	1,693.6	1,309.4
Imports, f.o.b.	3,041.7	2,914.9	2,751.0	2,956.5	2,489.5	2,316.5
Services and transfers (net)	409.1	426.5	426.1	345.6	265.5	255.1
Current account deficit	-550.6	-695.1	-584.9	-853.8	-530.4	-752.0
(In percent of GNP)	(-7.7)	(-9.4)	(-7.7)	(-10.9)	(-6.6)	(-9.2)
Grants, direct and portfolio investment	328.5	381.5	233.0	228.9	152.2	185.2
Medium- and long-term loans (net)	233.6	285.3	323.2	320.1	260.8	432.6
Disbursements	512.5	569.2	647.7	684.7	643.2	826.2
Amortization	278.9	283.9	324.5	364.6	382.4	393.6
Short-term capital and other adjustment	66.6	52.8	14.9	159.0	--	--
Capital account	628.7	719.6	571.1	708.0	413.1	617.8
Overall balance	78.1	24.5	-13.8	-145.8	-117.3	-134.2
Debt service						
Total service payments	458.2	468.6	519.5	602.2	630.2	647.9
Of which: interest	(179.3)	(184.8)	(194.8)	(237.3)	(247.8)	(254.4)
Debt service ratio 1/	13.6	14.7	16.6	19.6	21.1	24.9
External debt (disbursed)						
Amount outstanding	2,654.1	2,974.1	3,304.0	3,708.5	3,824.9	4,257.5
In percent of GNP	38.0	41.8	45.3	50.6	46.6	52.7
Memorandum item:						
Exports of goods, services, and transfers	3,377.6	3,184.3	3,123.3	3,082.1	2,980.2	2,599.5

Sources: Data provided by the Tunisian authorities (Ministry of Plan); and staff estimates and projections.

1/ As a percent of exports of goods, services, and transfers.

yielding about D 100 million (1.4 percent of GNP). It also included restraint in expenditure mainly through a slowdown in new employment (4,000 in 1986 as against 12,000 in 1985), a reduction of 18 percent in budgetary transfers to the Price Stabilization Fund, and a reduction in capital expenditure. However, the recent drop in oil prices and a slower than anticipated expansion in imports in 1986 will result in a shortfall in revenue of about D 90 million (1.3 percent of GNP). In addition, increases in dependency and other allowances announced in May will increase transfers to households by about D 30 million. Even though an increase in the minimum wage has been decided recently, the rate of increase is yet to be announced, and it is expected that wages in the government sector will not be appreciably affected by this increase. In sum, the overall deficit is now estimated by the staff at about 8.6 percent of GNP, with revenue increasing by 1.2 percent and expenditure by 4.5 percent.

The external current account deficit, which at the beginning of the year was projected to widen to 7.1 percent of GNP in 1986 (from 6.6 percent in 1985), is now likely to be significantly higher at about 9 percent of GNP. Nonenergy exports in SDR terms are expected to be virtually flat, while energy exports are expected to fall by more than one half. Tourism receipts are expected to increase only slightly, reflecting the perceived security problems in the Mediterranean area, and workers' remittances are expected to decline further by 11 percent. Imports are expected to fall by about 7 percent mainly due to a drop by over 40 percent in energy imports. In order to finance the initially projected current account deficit, the authorities had planned to step up foreign commercial bank borrowing to US$250 million in 1986 from about US$100 million in 1985. Should current account developments correspond to the more recent expectations, and the projected level of new borrowing not be realized, the external situation could become even more critical, as reserves are nearly exhausted. During the first 3 months of the year, gross official reserves declined further by about SDR 150 million, to SDR 85 million, the equivalent of less than 2 weeks of imports. The debt service ratio, partly reflecting the decline in oil prices, is projected to rise to 25 percent.

The exchange rate of the Tunisian dinar is determined with reference to a basket of seven currencies. Measured against a wider basket of 17 partner and competitor countries weighted by non-oil trade and tourism, the nominal effective exchange trade depreciated by 2.2 percent through 1985 (see Chart). Over the period 1981-85 the real effective exchange rate (using the wholesale price index as deflator) appreciated by about 5 percent, while Tunisia's terms of trade deteriorated by about 6 percent, and debt payments rose sharply in relation to current receipts. More importantly, staff calculations of bilateral real exchange rates show that, with the exception of the U.S. dollar, against which the dinar depreciated by 30 percent, the dinar appreciated by 5-27 percent during 1981-85 against the currencies of the major partner and competitor countries.

III. Topics for Discussion

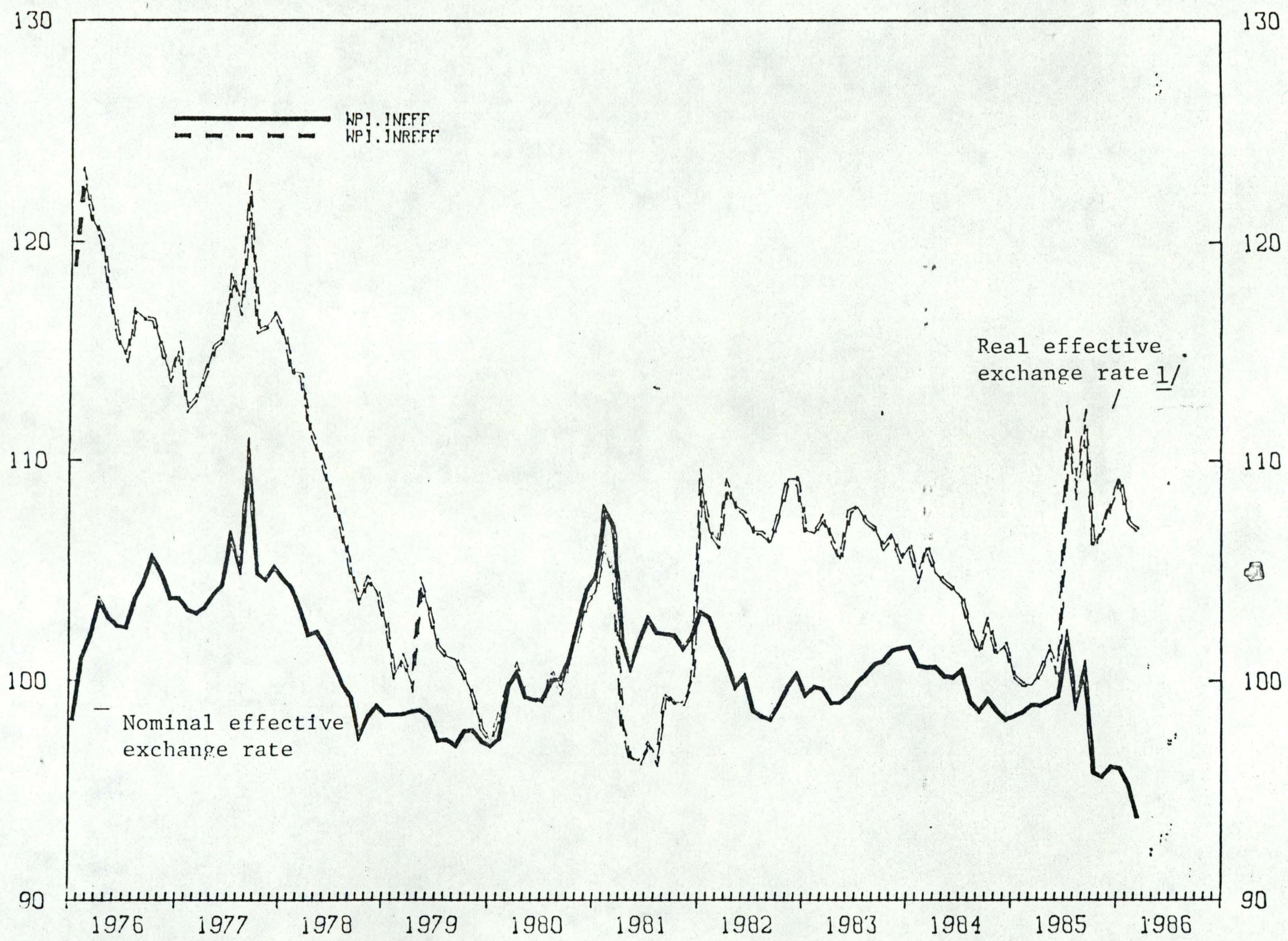
In the Summing Up concluding the 1985 Article IV consultation with Tunisia, serious concern was expressed about the sharp deterioration in the domestic and external financial situation. While it was recognized

CHART

TUNISIA

NOMINAL AND REAL EFFECTIVE EXCHANGE RATES, 1978-MAR 1986

(1980=100: Foreign currency per Tunisia dinar)



1/ Based on relative wholesale prices (seasonally adjusted); downward movement of index indicates depreciation.

that exogenous factors had contributed to this weakening, the sizable fiscal deficits and expansionary monetary and credit policies were cited as important factors. The additional restrictions being placed on imports were viewed with particular disfavor. The Tunisian authorities were explicitly urged to devise and implement without delay a comprehensive adjustment program, and note was made of several key policy areas where a strengthening was required.

The Fund staff has been informed that the Tunisian authorities are making progress in formulating an adjustment program within the medium-term context of the Seventh Development Plan (1987-91). Moreover, a package of adjustment measures was to be announced at end-June 1986, including an exchange rate action. The staff has also been informed that the Tunisian authorities may want to discuss the possible future use of Fund resources both under the credit tranches and the compensatory financing facility.

In conducting the Article IV consultation discussions, the mission would focus on assessing the current situation and the medium-term prospects, and, taking into account the content of the previous Summing Up, would examine closely with the authorities appropriate short- and medium-term macroeconomic targets and the specific policy areas that need to be strengthened in support. Such discussions could serve as a step in the formulation of an adjustment program, which could eventually be supported by an upper credit tranche stand-by arrangement.

1. External sector policies

At the outset, the mission would stress the need for a progressive reduction in the external current account deficit consistent with a level and pattern of financing which would result over the medium-term in (i) a reserve buildup to the equivalent of about two months of imports and (ii) stability of the debt service ratio at about its present level of 25 percent to be followed by a gradual decline in the years beyond 1991. Central to the external account objective as well as to the overall economic performance of Tunisia would be an active exchange rate policy combined with reductions in both import restrictions and tariff protection. The mission, taking account of any recent exchange rate action, would quantify the need for a further prompt effective real depreciation of the Tunisian dinar and call for a continued monitoring of the adequacy of the rate.

With regard to import restrictions, the Government has in principle agreed with the World Bank on a phased reduction in restrictions to be implemented later this year. The mission would ascertain the currently intended timetable for these reductions, with precision as to restrictions on raw materials, semifinished products, spare parts, and capital goods. The mission would attempt to quantify the impact of these actions on the balance of payments.

With respect to tariff reform and in line with the objective of establishing a reasonably uniform level of effective protection in the medium term, as is being proposed by the World Bank, the Government is expected on January 1, 1987 to increase minimum duties to 15 percent, including the customs formality tax (5 percent); establish a maximum duty of 50 percent; and reduce by 5 percentage points all import duty rates between 30-50 percent. The mission would encourage that these actions be effected as scheduled. Also, the mission will urge that as already agreed with the World Bank, the Government commence in January 1987 a detailed study of tariff reform and the system of effective protection.

2. Budgetary policies and public enterprises

The mission would urge the authorities to implement early budgetary actions to reduce the consolidated central government deficit in 1986. The mission would stress the need for further improvement for 1987 through direct budgetary actions within a medium-term fiscal policy profile envisaging sustainable overall deficits by 1990. It appears that, in the immediate period, the expenditure side offers the most scope for compressing the deficit. However, for the medium term the authorities should aim at improving the elasticity of revenue and at encouraging additional tax effort to avoid undue cuts in expenditure that might be counterproductive. In the meantime, the authorities should focus on restraining public sector wage and salary rates, as well as employment levels, and attempt to scale down both subsidy payments and investment outlays. The mission would propose limits on the net annual intake of new government employees and on the annual increase in the total wage and salary bill.

In the past two years, the Government has gradually increased the prices of subsidized consumer and producer goods to reduce the burden of subsidies (3.3 percent of GNP in 1986). The actions have been taken on two fronts: (i) reducing the number of commodities to be subsidized and (ii) reducing the per unit subsidy. The mission will encourage the authorities to continue to reduce the subsidy burden within a medium-term framework that will place products being subsidized into three categories of increasing socio-political importance. The mission would suggest that subsidies on products in the first category be abolished; those in the second category be reduced by restricting them to a fixed per unit basis, with a view to abolishing them in the medium term; and those in the third category (a limited number of commodities to which subsidies would continue) be reduced to a smaller scale than at present. The mission would discuss a possible precise timetable for these actions and attempt to quantify their budgetary impact.

The mission will encourage the authorities to scale down public investment by reducing direct government investment and cutting the Government's contribution to public enterprise investments. The Government's objective for 1986 has been to reduce total capital expenditures by 2 percentage points to 11 percent of GNP. The Government intends to assess and discuss the future investment program with a Public Expenditure Review mission of the World Bank currently in Tunis. The findings of this mission will provide an important input for the formulation of the expenditure policy for 1987 and for the medium-term budgetary targets.

The Government is currently implementing a tax reform, the main elements of which are (i) to reduce tax rates and improve administration; (ii) to simplifly the tax system; and (iii) to change progressively the existing turnover tax into a value-added tax (VAT) system. However, the growth in fiscal receipts in the medium term will be tempered by the current development focus on export industries and agriculture, sectors which are lightly taxed; the sharp decline in oil prices and revenues; and the planned reduction in import tariffs.

Nevertheless, the mission would stress that actions be taken to facilitate implementation of the tax reform. In conformity with the recommendation of a Fund technical assistance mission, the mission would emphasize a more rapid introduction of a coherent VAT to widen the tax base and reduce reliance on import taxes.

Public enterprises are a large fiscal burden, accounting for about 10 percent of total government expenditure (4 percent of GNP). The Government is currently in the process of undertaking a wide-ranging reform aimed at (i) reducing the number of enterprises under government control, including, for those deemed nonstrategic, the transfer of management and financing responsibilities increasingly to the private sector and development banks; and (ii) achieving the financial rehabilitation of those enterprises remaining within the direct control of the Government. The mission would stress the need for accelerating the ongoing reform in close coordination with the World Bank, which has scheduled a mission to visit Tunisia by the end of 1986. In the meantime, the mission will suggest that actions be taken relating to the pricing for public utilities.

3. <u>Price liberalization</u>

The Government is in the process of preparing a three-year program (1986-88) to decontrol industrial prices. The mission would ascertain the currently envisaged content and pace of this liberalization, identifying, in particular, the commodities to be liberalized in the near future. In agreement with the World Bank, it had been envisaged that it would be possible to abolish price controls immediately for construction materials, textiles, and other diverse industries.

Moreover, it was intended to have liberalization of prices for all industries considered by the investment agency (API) as sufficiently developed, except when the number of producers is not large enough to ensure competition. For industries that would remain subject to price control during 1986-88 and beyond, the relevant enterprises were to be allowed to adjust their prices on the basis of pre-agreed criteria and after a reasonable notification period, unless the authorities presented a duly justified objection. The mission would urge the authorities to press ahead with this policy. As regards agricultural prices, the mission would emphasize the need for appropriate incentives; in particular, it would be stressed that the authorities not restrain any needed increases in producer prices by their concern regarding consumer prices.

4. Liberalization of investments

Over the next few years the Government intends to abolish gradually controls on investments that do not request special incentives, in coordination with the liberalization of prices and import trade. This would be accomplished within the framework of a new system of investment incentives that would do away with across-the-board incentives, but would focus on promoting exports, regional development, and technology transfer. It was envisaged that before end-1986 the requirement of prior approval would be abolished for all new small investments valued at less than D 200,000, and for all replacement investments which are not subject to import licensing and do not request any special incentives from the Government. Confirmation of this intention would be sought, and the mission would encourage some further liberalization beginning in early 1987.

5. Money and credit

The mission would stress the need for a marked deceleration in the growth of broad money. As over the past few years there has been rapid growth in credit extended by nonmonetary financial institutions (to a level at end-1985 equivalent to 21 percent of bank credit to the economy), the mission would suggest that the authorities' monetary and credit framework incorporate the operations of such institutions. Specifically, the mission would call for containing the growth in broad money to a rate substantially below the projected rate of growth in nominal GNP, with corresponding restraint on credit expansion after taking into account the balance of payments objective. To allow adequate credit for the nongovernment sector, the authorities should limit bank credit to the Government. Also, the possibility of moving from the present system of generally direct credit controls to monetary control based increasingly on regulating the monetary base will be explored.

With respect to interest rates, following adjustments in 1985, rates have remained generally positive in real terms. The mission would suggest that an active interest rate policy be pursued so as to maintain real positive deposit and borrowing rates. Given the existence of price controls in Tunisia, the mission would point out that in establishing rates, comparisons should also be made with international interest rates. In addition, the mission would suggest strongly a simplification of the interest rate structure, with a reduction to a minimum in the number of preferential rates, and a liberalization of margins on both lending and deposit rates.

6. Possible future use of Fund resources

If requested by the Tunisian authorities, the mission would be authorized to discuss the possible future use of Fund resources under the credit tranches. The mission would point out that a program to be supported by a stand-by arrangement would contain quantified objectives and detailed policy measures designed to achieve those objectives.

While the Article IV consultations would provide an opportunity for the staff to discuss Tunisia's current situation, economic objectives and prospects, and appropriate supporting policies, the formulation of a comprehensive and quantified adjustment program to be supported by a stand-by arrangement would require further discussions. If the authorities wish to pursue their interest in the use of Fund resources in the credit tranches, a Fund mission would return for that purpose.

Concerning Tunisia's possible request for the use of Fund resources under the CFF, the mission would inform the authorities that access would depend upon an assessment at headquarters of the size of the export shortfall, the test of cooperation, and the other criteria for use of the facility.

TUNISIA --Relations with the Fund

(As of May 31, 1986)

I. Membership status

Date of membership:	April 14, 1958
Status:	Article XIV

A. Financial Relations

(In millions of SDRs)

II. General Department (General Resources Account)

Quota:	138.2
Total Fund holdings of Tunisia's currency:	113.4 (82.0 percent of quota)
Fund credit:	None
Reserve tranche position (amount):	24.8
Current operational budget (maximum use of currency):	0.7
Lending to the Fund (amount):	None

III. Current stand-by arrangement or special facilities	None

IV. SDR Department

Net cumulative allocation (amount):	34.2
Holdings:	None

V. Administered accounts	Not applicable
VI. Overdue obligations to the Fund	None

VII. Most recent use of Fund resources

1977: Compensatory Financing Facility	24.0

B. Nonfinancial Relations

VIII. Exchange rate arrangement

The exchange rate of the Tunisian dinar is determined in accordance with a basket of currencies. Buying and selling rates for foreign currencies are determined daily by the Central Bank. As of May 30, 1986, the dinar rate of the U.S. dollar was D 1 = US$1.291 equivalent to D 1 = SDR 1.129.

Tunisia--Relations with the Fund (concluded)

IX. Last Article IV consultation

The last Article IV consultation discussions were held in Tunis during the period July 22-August 2, 1985, and the staff report (SM/85/261) and the report on recent economic developments (SM/85/281) were discussed by the Executive Board on November 12, 1985. The decision adopted was as follows:

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Tunisia, in light of the 1985 Article IV consultation with Tunisia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. In the framework of its policy of rationalizing domestic investment, Tunisia has modified, since the previous consultation, its system of exchange restrictions by shortening the list of freely importable products; at the same time, there has been an easing of restrictions in respect of some invisible transactions. The Fund urges the authorities to ease the remaining restrictions on payments and transfers for current international transactions.

The summing-up specified the standard 12-month consultation cycle.

X. Technical assistance

FAD: Study of planned tax reform (April 18-May 7, 1982)

Assistance in preparing government financial accounts on a GFS basis (January 11-February 3, 1983)

Study of the fiscal reform (January 13 - February 1, 1985)

BUR-AFR: Lectures in Tunisia (Central Bank) on balance of payments methodology and analysis (March 31-April 18, 1986)

Financial Relations of the World Bank Group with Tunisia

Date of membership - IBRD: April 1958
Capital subscription - IBRD: SDR 37.3 million

IBRD/IDA lending operations 1/	Committed		Disbursed	
	IBRD	IDA	IBRD	IDA
	(In millions of U.S. dollars)			
Agriculture and rural development 2/	324.0	8.9	170.4	8.9
Education	60.2	19.4	13.4	19.4
Health and population	12.5	9.5	2.7	9.5
Energy	170.2	--	115.9	--
Transportation	260.4	16.9	173.1	16.9
Industry and tourism	317.9	10.0	174.7	10.0
Technical assistance	17.9	--	3.7	--
Urban water supply and sewerage	317.6	10.5	180.6	10.5
Total	1,480.7	75.2	834.5	75.2
Repayments	267.1	10.1		
Debt outstanding (including undisbursed)	1,213.6	65.1		
IFC operations (gross commitments)	31.3			

Source: World Bank

1/ Through the end of May 1986.
2/ Includes the following Bank loans which are not yet effective:
(a) The NW Agricultural Production Project (Loan No. 2502-TUN) of US$15 million.
(b) The Irrigation Management Improvement Project (Loan No. 2573-TUN) of US$22 million.
(c) The Gabes Irrigation Project (Loan No. 2605-TUN) of US$27.7 million.

Recent World Bank Missions

January 1986: Economic mission
April 1986: Agricultural Structural Adjustment Loan (appraisal mission)
June-July 1986: - Industrial Trade and Policy Adjustment Loan (preparatory mission)
- Public Expenditure Review mission

Tunisia--Statistical Issues

1. Outstanding Issues

a. General economic data

The weights of the wholesale price index (WPI), base year 1970, are becoming outdated. Data on the indices for mining and industrial production (base year 1977) have not been reported since December 1983. The mission will ascertain whether there are plans to rebase the WPI and the reasons for the absence of recent data on the mining and industrial production indices.

b. Government finance

The 1985 GFS Yearbook includes data for central and local governments through 1982. However, the reply to the 1986 GFS questionnaire did not include data for local governments. The mission will inquire when the Bureau of Statistics can expect to receive local government data.

c. Monetary accounts

With respect to the reporting of data for commercial banks and the other financial institutions, there has been a continuing problem with the separate identification of foreign liabilities, in particular, long-term foreign borrowing. The mission will discuss this matter with the authorities with a view to ensuring that appropriately disaggregated data are reported on a regular basis.

The mission will seek to obtain from the authorities some information on the offshore banking activities of banks in Tunisia and the treatment of their data in the monetary accounts.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for Tunisia in the June 1986 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Tunisia, although the data on mining and industrial production have become increasingly uncurrent.

Status of IFS Data

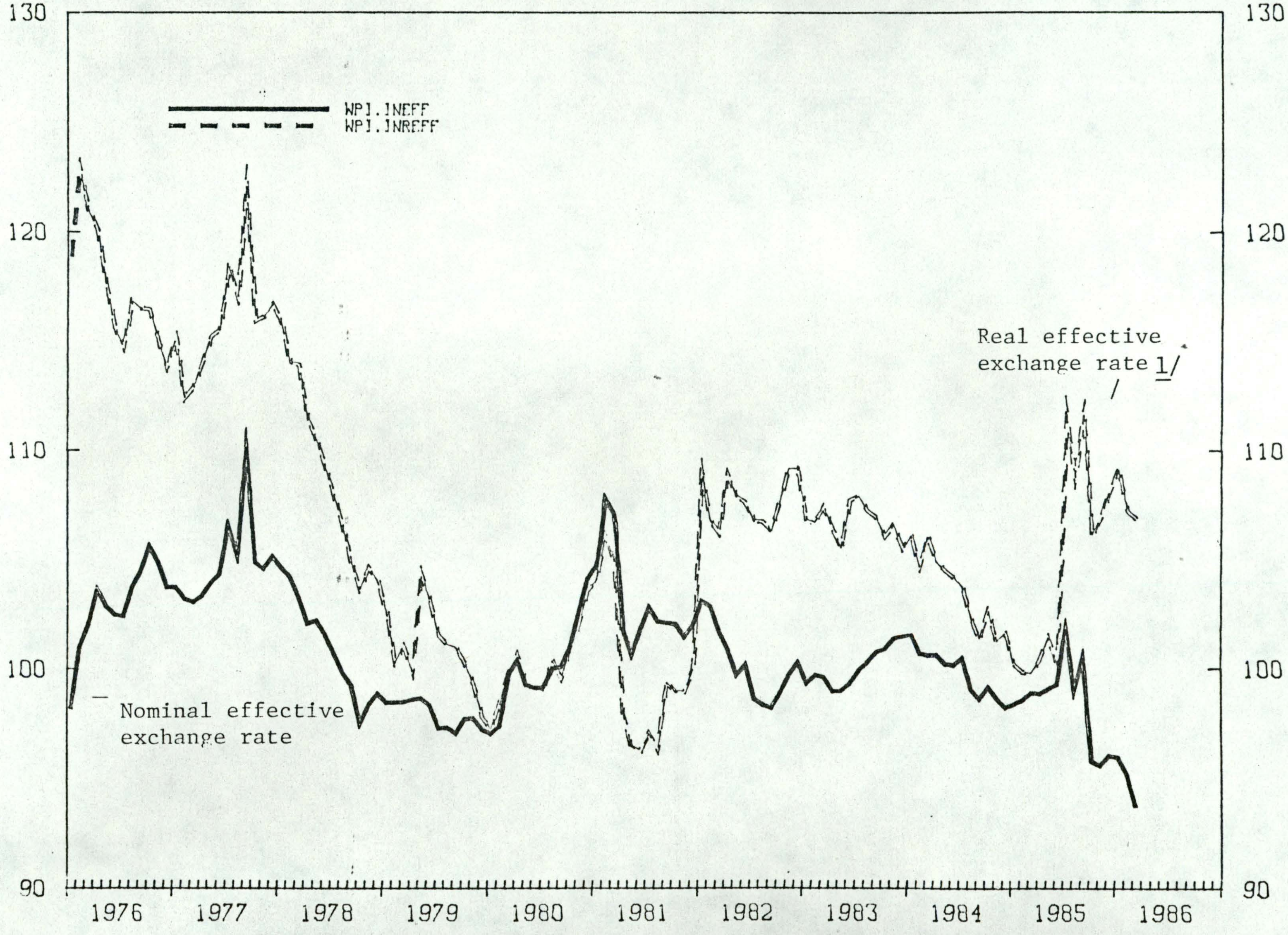
		Latest Data in June 1986 IFS
Real Sector	- National accounts	1984
	- Prices: CPI	December 1985
	WPI	June 1985
	- Production: Industrial	December 1983
	Mining	December 1983
	Crude petroleum	October 1985
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1982
	- Financing	1982
	- Debt	1982
Monetary Accounts	- Monetary authorities	January 1986
	- Deposit money banks	December 1985
	- Other financial institutions	October 1985
Interest Rates	- Discount rate	December 1985
	Bank lending/deposit rate	December 1985
External Sector	- Merchandise trade:	
	Values	December 1985
	Prices: Exp. unit value	1983
	Imp. prices	June 1985
	- Balance of payments	1984
	- International reserves	February 1986
	- Exchange rates	April 1986

CHART

TUNISIA

NOMINAL AND REAL EFFECTIVE EXCHANGE RATES, 1978- MAR 1986

(1980=100: Foreign currency per Tunisia dinar)



1/ Based on relative wholesale prices (seasonally adjusted); downward movement of index indicates depreciation.

RECEIVED
1984
EXCHANGE & TRADE RELATIONS

Office Memorandum

cc: Mr. Bellemare
Mr. Kanesa-Thasan

TO: Managing Director
Deputy Managing Director

April 12, 1984

FROM: Ch. A. François Chtz

SUBJECT: Tunisia--1984 Article IV Consultation Discussions and Possible Request for a Drawing Under the Compensatory Financing Facility

A mission comprising Messrs. Rothman (AFR), Sacerdoti (AFR), Wickham (RES), Dairi (AFR), Ms. Elwell (secretary-AFR), and myself visited Tunis during the period March 20-April 3, 1984 to hold Article IV consultation discussions. Mr. Salehkhou attended the concluding meetings. As usual, the Tunisian technical preparation for the mission was excellent, and the mission had several separate extensive meetings with the new Ministers of Finance (Mr. M'Barka) and Planning (Mr. Khelil) and with the Governor of the Central Bank of Tunisia (Mr. Belkhodja). At the close of the missions's stay, the Governor communicated to the mission the intention of the Tunisian authorities possibly to seek a drawing equivalent to 50 percent of quota (SDR 69.1 million) under the CFF (see page 4 below); the request could be presented to the Executive Board with the 1984 Article IV consultation reports.

The mission took place against a backdrop of political and social uneasiness, following widespread violence in early January triggered by announced increases of about 100 percent in bread prices (subsequently rescinded) in the Government's attempt to eliminate cereal subsidies (amounting to some 3 percent of GNP). Although some press accounts had linked the price hikes to Fund "dictates", there was no hesitation on the part of the Tunisian authorities to discuss frankly and in a most cooperative manner with the mission the economic and financial problems confronting Tunisia.

Although the mission examined in detail the outlook for 1984, the focus of the discussions was on medium-term policies which would enable Tunisia to maintain a viable balance of payments and debt posture. At the outset, it should be noted that due to a prolonged drought, a less favorable-than-anticipated external environment, and slippages in policy implementation, the major objectives of the Sixth Development Plan (1982-86) will likely not be realized, including importantly the envisaged annual average growth of 6 percent in real GDP and reduction in the external current account deficit as a percentage of GNP from 7.6 percent under the Fifth Development Plan to an average of 7.1 percent over the 1982-86 period.

Outlook for 1984

Real GDP is officially projected to rise by 5.5 percent in 1984 (4.5 percent in 1983) under the assumption of a more normal level of agricultural production following two years of widespread drought. At the same time, consumer prices are forecast to rise by less than 8 percent (Dec.-Dec.), after a 6 percent rise in 1983 (which was, however, effected in large measure by a "voluntary" restraint in price rises during the first half of the year). Close "supervision" over prices will be maintained in 1984 as the authorities' attempt to implement a wage freeze this year is tied to their ability to contain the rise in consumer prices to the 8 percent rate. In the financial area, prospects are not encouraging. Despite a number of measures taken in the fiscal field (after the rollback in bread prices)--increases in several types of taxes, price increases for "luxury" commodities, and expenditure restraint (including a wage freeze)--the overall fiscal deficit is anticipated to rise further to 7.6 percent of GNP (5.5 percent in 1983), as a result of a large increase in recurrent subsidies and other transfers, which would reach 13 percent of GNP. Moreover, continuing the trend of recent years, both domestic credit and monetary expansion are projected to exceed by a significant margin (5-6 percentage points) the anticipated growth in nominal GNP.

Regarding the external accounts, the current account deficit is expected to widen marginally to 8.1 percent of GNP (7.8 percent in 1983), with modest growth (about 5 percent) projected for both exports and imports in SDR terms. However, the current account deficit over the past year has been contained by a tightening of import controls. With continued growth envisaged for direct investment and foreign borrowing, overall balance of payments equilibrium is projected, compared with a small surplus (SDR 14 million) in 1983. Nevertheless, during the first two months of 1984, Tunisia's gross official international reserves fell by SDR 181 million, to SDR 367 million, or to the equivalent of 1.7 months of projected 1984 imports. Tunisia's debt service ratio is expected to remain modest at 17.7 percent.

Medium-term prospects and policies

The mission discussed at length with the Tunisian authorities a "normative" balance of payments scenario through 1986, which took into account importantly the projected decline in net petroleum exports. The scenario was premised mainly on the assumption that the authorities could effect major macro-structural changes, including containing consumption growth to that in GNP, reducing investment and imports relative to GNP, and spurring agricultural and industrial exports. The scenario resulted in stability of the external current account deficit at 8.1 percent of GNP over the period 1984-86 with an average debt service ratio of about 17 percent.

In view of prospects for a decline in net petroleum exports, the mission focused on policies and progress in export diversification. More generally regarding efforts to strengthen the current account and permit a desired easing of the extensive restrictive system, the mission reiterated the need for appropriate demand-management and exchange rate policies as effective instruments. With respect to the latter, at the request of the Tunisian authorities, the Fund staff prepared several comprehensive exchange rate indicators (using, importantly, measures of labor and other production costs) to guide the authorities in their exchange rate policies. The Central Bank authorities greatly appreciated the extensive technical cooperation provided to them by Mr. Wickham and expressed their desire that such close cooperation continue in the future. Broadly, the indicators suggest an erosion of Tunisia's competitiveness over the past two years on the order of 5 percent, stemming mainly from rapid increases in domestic labor costs and import duties. In view of this, the mission recommended that exchange rate policy (the Tunisian dinar is tied to a basket of currencies) be conducted in a manner to offset the recent appreciation and prevent future real appreciations. The authorities expressed reluctance to offset the appreciation with a discretionary change in the rate, preferring instead to allow anticipated domestic wage and price stability in 1984 to reverse the erosion in competitiveness.

In the fiscal area, although enhanced revenues are ultimately expected from a tax reform (aimed importantly at increasing the direct tax base and expanding the coverage of value-added taxation) currently being implemented, the mission noted that future growth in revenues will likely be modest, as petroleum-related receipts decline and imports increase less rapidly than GNP. Therefore, the mission noted that, in addition to stepping up effective implementation of the tax reform, the authorities consider raising the prices of certain petroleum products, which remain below international levels and represent an important potential near-term source of revenues for the Government. However, in view of the already high revenue burden--35 percent of GNP--the mission stressed that strong efforts will be required to contain the growth in expenditures to a rate below that in GNP. Although the mission did not suggest specific cuts in outlays, it pointed out those expenditure components which have grown particularly rapidly in recent years (salaries, subsidies and other transfers to households and public enterprises, and goods and services on the recurrent account).

In examining developments in the public enterprise sector, the mission pointed to the growing absorption by this sector of Tunisia's financial resources : budgetary financial aid is equivalent to about 5 percent of GNP, and bank credit to public enterprise accounts for almost one-third of credit to the economy (the nongoverment public and private sectors). While recognizing social and political constraints, the mission suggested that progress be made in improving the efficiency and financial performance of the public enterprises, including through the use of more appropriate pricing policies.

With respect to monetary and credit policy, the mission called for a less accomodative policy. It emphasized once more the apparent need for upward revisions in interest rates. Interest rates have not been changed, for the most part, since April 1981, and are generally slightly negative in real terms. However, the interest rate on convertible dinar accounts has recently been increased from 2 percent to 9 percent to attract a larger flow of workers' remittances.

Tunisia's present debt service burden is manageable, and Tunisia maintains a relatively high credit rating in the international credit markets. The authorities recognize the need to contain the increase in external debt (now 45 percent of GNP), both to forestall strains on debt service capacity and to protect Tunisia' credit rating.

Possible CFF Request

In view of the authorities' renewed interest in a CFF request (for 50 percent of quota), the mission, as instructed in its brief, collected a substantial portion of the required information, which is now being analyzed at headquarters. Preliminary calculations show that Tunisia in 1983 experienced an export shortfall in excess of 50 percent of quota. The mission also explained to the authorities the guidelines regarding the requirement of cooperation that have recently been approved by the Executive Board. The mission indicated further that a closer assessment at headquarters of the stance of Tunisia's economic and financial policies in relation to its balance of payments difficulties would form the basis for a judgment by management on Tunisia's meeting the requirement of cooperation for a possible CFF request.

The mission believes that a possible Tunisian request under the CFF merits careful consideration. On technical grounds, the export shortfall in 1983 was largely attributable to the drought, which severely dampened agricultural exports, and generally weak external demand, factors which were beyond the control of the authorities. Regarding the test of cooperation, the authorities continue to engage in a frank and extensive dialogue with the Fund staff. With respect to the adequacy of Tunisia's policy stance, as discussed above there are major shortcomings, especially in the fiscal and monetary areas. However, by their actions in January (recognizing and attempting to eliminate cereal subsidies) and their subsequent efforts in the budgetary and incomes policy areas, the authorities attempted to contain the deterioration in the domestic financial situation and in the external accounts. They believe that these actions are sufficient to justify a CFF drawing of up to 50 percent of quota. In view of the existing political and social constraints, the authorities' room to maneuver further in 1984 is very limited and it is doubtful whether additional corrective policies will be implemented by year-end. Although a final decision to proceed with a CFF request has not been made by the authorities, the Governor wished to receive a prompt reply as to whether a CFF request would be treated favorably by management. He also expressed an interest in speaking directly to you during the current Interim Committee meetings. We should greatly appreciate your reaction to this possible request.

Possible Request for Technical Assistance

The Minister of Finance indicated to the mission that he intends to request technical assistance in the context of the tax reform, specifically to evaluate the extent of tax evasion and to formulate actions to reduce it.

Consultation cycle

The authorities agreed to hold the next Article IV consultation discussions on the standard 12-month cycle.

cc: ASD
CBD
ETR
EUR
EXR
FAD
INST
LEG
MED
RES
SEC
TRE
WHD
Mr. Collins

Tunisia: Selected Economic and Financial Indicators, 1980-84

	1980	1981	1982	1983 Preliminary	1984 Projections
	(Annual percent changes)				
National income and prices					
GDP at constant prices	4.3	5.7	0.3	4.5	5.5
GDP deflator	14.5	11.4	16.8	8.4	6.6
Consumer prices	10.0	9.0	13.6	9.0	8.6
External sector (in SDRs)					
Exports, f.o.b.	32.9	13.1	-13.9	-2.8	5.1
Imports, c.i.f.	26.3	15.1	-4.2	-5.3	5.2
Terms of trade (deterioration -)	14.3	6.7	-1.4	-1.6	1.5
Nominal effective exchange rate (depreciation -) 1/	-0.1	1.9	-5.4	-5.0	...
Real effective exchange rate (depreciation -) 2/	-0.8	1.3	7.0	-2.4	...
Central government operations (consolidated basis)					
Revenue and grants	18.8	18.0	24.1	14.2	15.7
Total expenditures and net lending	12.7	17.1	32.2	15.2	21.3
Money and credit					
Domestic credit	17.6	24.3	23.4	19.3	16.8
Government	(2.3)	(16.4)	(20.1)	(15.0)	(36.5)
Economy	(20.5)	(25.6)	(23.8)	(19.9)	(14.0)
Money plus quasi-money	18.6	19.3	18.9	18.5	18.1
Interest rates					
Discount rate	5.75	7.00	7.00	7.00	...
12-18 month time deposit	5.25	7.00	7.00	7.00	...
General rediscountable advances	7.0-7.5	8.0-8.5	8.0-8.5	8.0-8.5	...
	(Ratios; in percent of GNP unless otherwise indicated)				
Central government consolidated deficit (-)	-2.8	-2.6	-5.1	-5.5	-7.6
Domestic bank financing	(0.1)	(0.9)	(1.1)	(0.9)	(2.1)
Gross fixed capital formation	27.8	30.9	31.4	29.4	28.2
Gross national savings	24.7	24.7	23.0	22.0	21.4
External current account deficit (-)	-5.0	-5.8	-8.3	-7.8	-8.1
External public debt	35.1	38.2	41.2	44.8	45.1
Debt service/Exports of goods and nonfactor services plus private transfers	12.1	14.6	15.9	16.6	17.7
Gross official international reserves (in months of imports, f.o.b.)	2.5	2.1	2.5	2.6	(Feb.) 1.7
	(In millions of SDRs)				
Overall balance of payments (deficit -)	55	84	25	14	--
Gross official international reserves (at end of period)	469	467	556	548	(Feb.) 367
External public debt	2,322	2,654	2,974	3,237	3,682

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

1/ Export-weighted on a multilateral basis.

2/ Export-weighted on a multilateral basis deflated by relative wholesale price indices.

un Kanesa-Thasan

Office Memorandum

BLUE FOLDER
ETR FILES

TO: Managing Director
Deputy Managing Director

March 7, 1984

FROM: J. B. Zulu JBZ.

SUBJECT: Tunisia - Briefing Paper for the 1984 Article IV Consultation

Please find attached for your approval the briefing paper for the forthcoming mission to Tunisia.

This paper has been cleared with:

ETR (Mr. Kanesa-Thasan)
FAD (Mr. Yandle)
LEG (Mr. Oh)
RES (Messrs. Kaibni and Lanyi)
TRE (Mr. Leddy)
AFR (Mr. Woodward)

The mission chief's last day in office is March 16.

Attachment

cc: Mr. Collins

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

TUNISIA

Briefing Paper - 1984 Article IV Consultation

Prepared by the African Department

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, Research, and Treasurer's Departments)

Approved by J.B. Zulu and S. Kanesa-Thasan

March 7, 1984

I. Introduction

A mission comprising Messrs. François (head-AFR), Rothman (AFR), Sacerdoti (AFR), Dairi (AFR), and Ms. Elwell (secretary-AFR) will visit Tunis during the period March 20-April 3, 1984 to hold Article IV consultation discussions. Also, Mr. Wickham (RES) will accompany the mission for technical discussions on exchange rate indicators prepared at the request of the Tunisian authorities. The last consultation discussions were held in March 1983, and the staff report (SM/83/100) was discussed by the Executive Board on August 26, 1983. Summaries of Tunisia's relations with the Fund and the World Bank Group and a table containing selected economic and financial indicators are provided in the attached appendices.

Tunisia continues to avail itself of the transitional arrangements under Article XIV.

II. Background

Following a prolonged period of relatively rapid real economic growth, domestic financial stability, and a generally strong balance of payments position, Tunisia's economic and financial performance in the past two years has weakened. While exogenous factors such as drought and slackened external demand have dampened economic activity, expansionary fiscal, monetary, and incomes policies have generated excessive domestic demand pressures.

In 1982 there was a pronounced and widespread deterioration. Real gross domestic product (GDP) stagnated, while domestic inflation accelerated from 9 percent to almost 14 percent. In the financial area, despite high growth in revenues (24 percent) associated with petroleum-related receipts, the consolidated central government budget deficit doubled as a percentage of gross national product (GNP) to 5 percent, as the increase in expenditures accelerated to 32 percent. In addition to rapidly rising investment outlays, high spending levels in recent years have stemmed mainly from increases in wages and salaries and in subsidies and other current transfers. In 1982 subsidies and transfers were equivalent to 22 percent of total expenditure and 9 percent of GNP. Consumer subsidies for wheat products alone accounted for about 5 percent of total outlays and were equivalent to 2 percent of GNP. Moreover, the government domestic bank borrowing requirement was significantly higher; bank credit to the economy (the private and nongovernment public sectors) rose by 24 percent; and money plus quasi-money continued to increase at a rate (19 percent) well above that in nominal GDP (16 percent). Due mainly to a decline in petroleum exports, the current account deficit in the balance of payments (excluding official transfers) widened to the equivalent of 9.3 percent of GNP (from 4.8 percent in 1980 and 7.6 percent in 1981). To finance the deficit, Tunisia continued to benefit from a high level of direct foreign investment but also had to increase its recourse to external borrowing. As a result of this and a substantial depreciation of the Tunisian dinar 1/ vis-à-vis the U.S. dollar, Tunisia's external public debt rose from 38 percent of GNP in 1981 to 42 percent in 1982.

In the staff appraisal section of the 1983 Article IV consultation report, it was noted that although for 1983 a rebound in overall economic activity was likely, the domestic financial situation as well as the external accounts were likely to deteriorate further. More specifically, the staff considered that, unless the authorities adopted a less accomodative credit policy, increased interest rates, and made efforts to curb budgetary outlays (by restraining wage increases, stretching out new recruitment, postponing some capital spending, and reducing subsidies and transfers), the budgetary deficit would widen to about 7 percent of GNP and the external current account deficit would rise by almost another percentage point of GNP.

In the event, real GDP is now officially estimated to have increased in 1983 by 4.5 percent. Also, the rise in consumer prices moderated to 9 percent. However, this moderation was achieved in part by a "voluntary" 6-month reduction in some prices and by an intensification of price

1/ At end-January 1984, D 1 = SDR 1.28966.

controls, which followed a period of price liberalization designed to improve the efficiency of resource allocation. Although wage increases for the public and private sectors were contained to 16 percent, well below those in 1982 (23 percent), there were no other substantive fiscal actions. Therefore, although data on the consolidated budgetary outturn are not yet available, in view of the reported level of external borrowing and data on government borrowing from the domestic banking system, the budget deficit may have exceeded the 7 percent of GNP projected by the previous mission. The growth in credit to the economy decelerated only slightly (to 20 percent), and the estimated increase in money plus quasi-money (19 percent) again widely exceeded the growth in nominal GDP (13 percent). Interest rates have not been changed, for the most part, since April 1981, and remain moderately negative in real terms.

Regarding the external accounts, official estimates now indicate a slight decline in 1983 in the current account deficit in terms of GNP (to 8.7 percent). Exports are estimated to have increased marginally (in SDR terms), while imports are shown to have declined slightly, but the lower import level may have been associated with a tightening of import controls in early 1983. Further substantial recourse was made to external borrowing, especially medium-term loans (including from the international financial markets). The public external debt rose to SDR 3.2 billion, and, with a further large depreciation of the dinar vis-à-vis the U.S. dollar, to 45 percent of GNP. At end-December 1983 Tunisia's gross official international reserves were equivalent to 2.5 months of imports (f.o.b.). Tunisia's debt service ratio for 1983 is estimated at 16.3 percent.

The exchange rate of the Tunisian dinar is determined on the basis of a basket of currencies containing the U.S. dollar, the French franc, the deutsche mark, and the Italian lira. During 1983 both the nominal and real effective exchange rates, as calculated by the staff for purposes of surveillance 1/, depreciated by about 1 percent.

Tunisia maintains a relatively complex exchange and trade system. The sale of foreign exchange continues to be limited for most invisibles, and payments for nonliberalized imports require prior authorization. Also, trade restrictions arise from the continued licensing of some imports. Over the past few years there had been a de facto relaxation of trade restrictions, due largely to an extension of the system of annual import authorizations, originally confined to industrial companies, to large trading firms and specialized retailers. However, in early 1983 annual limitations were tightened for industrial inputs and for imports of nonessential consumer goods by wholesalers and retailers. Regarding payments restrictions and procedures in invisibles, there has been a gradual easing, especially for allowances for travel and study abroad.

1/ These rates are calculated on a trade-weighted basis, with the real effective rates obtained by deflating by consumer price indices. Thus, in view of Tunisia's price control system, such calculations are less than satisfactory for indicating changes in Tunisia's competitiveness.

III. Topics for Discussion

As reported widely, in early January the Government announced sharp increases (about 100 percent) in bread prices in an attempt to eliminate subsidies on bread. The price increases, which in some press accounts were linked to "dictates" by the Fund and the World Bank, triggered widespread violence. However, these disturbances can be attributed also more broadly to frustration over continued high unemployment and social and regional income disparities. Subsequently, the sharp price increases were rescinded and replaced by modest adjustments (about 10 percent) along with the Government's stated intention to effect further increases around mid-year. As a consequence, the initially presented budget had to be revised. The revised budget was announced only in February, and the staff as yet has no detailed information on its content. However, the Prime Minister has strongly reaffirmed the need for austerity, and press reports note that the budgetary savings foregone as a result of the bread price rollback will be partially made up through taxes on luxury goods, cigarettes, and alcohol. On a more general level, although the authorities are well aware of and concerned about current economic and financial trends, and have attempted to design appropriate adjustment policies, recent experience has shown that policy implementation is extremely difficult. The democratization process, uncertainties regarding the succession of President Bourguiba, and the existence of strong trade unions have complicated the process of economic decision-making and have weakened the Government's authority. Thus, in view of the most recent social unrest, the Government is expected to be even more cautious in its initiatives.

Against this background, the mission will review with the authorities economic and financial developments in 1983 and the outlook for 1984 and the medium term. The mission would stress a major theme contained in the summing up at the conclusion of the 1983 Article IV consultation, namely, that a tightening of import restrictions and a halt in the price liberalization process are not appropriate substitutes for the demand-restraint and supply oriented measures required for Tunisia to maintain a viable balance of payments and debt posture.

The mission will examine carefully with the Tunisian authorities the balance of payments outlook. For 1984, official projections show a decline in the current account deficit to 7.7 percent of GNP (from 8.7 percent in 1983). Exports (in SDR terms) are forecast to rise by 3.3 percent, despite foreseen stagnation in petroleum exports, while the increase in imports is expected to be contained to 3.4 percent, despite a fall in volume in 1983 and a projected 5.5 percent increase in real GDP. The mission will discuss the feasibility of these projections.

For the medium term, in view of prospects for a decline in net petroleum exports, the mission would focus on policies (including an appropriate exchange rate) and progress in export diversification, particularly for agricultural and manufactured goods. More generally regarding efforts to strengthen the current account and permit a desired easing of the restrictive system, the mission would reiterate the need for appropriate demand-management and exchange-rate policies as effective instruments. With respect to the latter, at the request of the Tunisian authorities the Fund staff has recently prepared several comprehensive exchange-rate indicators (using, importantly, measures of labor and other production costs) to guide the authorities in their exchange rate policies. Broadly, the indicators suggest an erosion of Tunisia's competitiveness over the past two years, stemming from rapid increases in domestic labor costs and large depreciations in the currencies of important competitor countries. In view of this, the mission will assess further with the authorities the appropriateness of the level of the Tunisian dinar and, depending upon this assessment, may suggest more flexibility in exchange rate determination.

Tunisia's present debt service burden is manageable, and, prior to the recent disturbances, Tunisia maintained a relatively high credit rating in the international credit markets. The authorities recognize and the mission will stress the need to contain the increase in external debt, both to forestall strains on debt service capacity and to protect Tunisia's credit rating.

In the fiscal area, the mission would review with the authorities the revised 1984 budget and ascertain the expected impact of any significant actions on the expenditure and/or revenue fronts toward curbing the rising deficit. For the period beyond, although enhanced revenues are ultimately expected from a tax reform (aimed importantly at increasing the direct tax base) currently being implemented, the mission would note that future growth in revenues will likely be modest, as petroleum-related receipts decline. Therefore, the mission would stress that, in addition to a necessary speed-up in implementation of the tax reform and the recently announced tax measures, strong efforts will be required to contain the growth in expenditures, particularly by restraining personnel costs and reducing outlays for subsidies and transfers and nonessential capital projects. Also, on a related subject, the mission would review progress made in improving the efficiency and financial performance of public enterprises.

With respect to monetary and credit policy, the mission would point out that the pace of expansion of credit to the economy continues to outstrip by a significant margin the expansion in domestic production and that a less accomodative policy is called for. It would ascertain what policy assumptions underlie the projected slowdown in credit expansion to the economy (to 15 percent) in 1984 and emphasize, once more, the apparent need for upward revisions in interest rates, both to dampen the demand for credit and promote private sector savings. A World Bank mission, with Fund participation, is scheduled for late May for a comprehensive financial sector study, including importantly the areas of interest rates and credit control and allocation.

In the area of prices and wages, the mission will emphasize the desirability of resuming the price liberalization process. Also, it would urge further wage restraint to contain domestic demand and to ease cost pressures on Tunisia's productive enterprises.

The Tunisian authorities are currently re-examining the assumptions and objectives of the Sixth Development Plan (1982-86), which initially had envisaged an average annual real growth rate of GDP of 6 percent and a slight reduction in the external current account deficit as a percentage of GNP. The mission will discuss the implications of this review, including any major changes in macro-policies that the authorities may contemplate for the remaining part of the plan period. In particular, the mission would expect the revised projections and policies to be consistent with the maintenance of a sustainable debt profile and debt service burden. In April the World Bank will undertake a full-scale mid-term plan review, with particular emphasis on the investment program and financing, pricing policies, and the external balance. As in the past, close collaboration will be maintained between Bank and Fund staffs on these issues.

At the time of the last Annual Meeting, the Tunisian authorities expressed interest in a CFF drawing. However, they have not yet provided the necessary information requested then by the staff. On the basis of preliminary calculations, it appears that Tunisia in 1983 experienced a shortfall in its exports and an excess in its cereal imports which could support a request under the CFF. If the authorities renew their interest in a CFF request, the mission would collect the required information for analysis of the case at headquarters. The mission would explain to the authorities the guidelines regarding the requirement of cooperation that have recently been approved by the Executive Board. The mission would further indicate that the staff report on the 1984

Article IV consultation with Tunisia, in particular the staff's assessment of the stance of Tunisia's economic and financial policies in relation to its balance of payments difficulties, would form the basis for a judgement by management on the requirement of cooperation for a possible CFF request.

The mission will propose that the next Article IV consultation be held on the standard 12-month cycle.

TUNISIA -- Fund Relations

(As of January 31, 1984)

(In millions of SDRs)

I. Membership status

Date of membership:	April 14, 1958
Status:	Article XIV

Financial Relations

II. General department (General Resources Account)

Quota:	138.2
Total Fund holdings of Tunisia's currency	108.1 (78.2 percent of quota)
Fund credit:	None
Reserve tranche position (amount):	30.1
Current operational budget (maximum use of currency):	Not applicable
Lending to the Fund (amount):	Not applicable

III. Current stand-by or extended arrangement and special facilities

Not applicable

IV. SDR department

Net cumulative allocation (amount):	34.2
Holdings:	3.6 (10.5 percent of net cumulative allocation)
Current designation plan (amount of maximum designation):	Not applicable

V. Administered accounts

Not applicable

VI. Overdue obligations to the Fund

None

VII. Most recent use of Fund resources

1977: Compensatory Financing Facility 24.0

Nonfinancial Relations

VIII. Exchange rate arrangement

The exchange rate of the Tunisian dinar is determined in accordance with a basket of currencies. Buying and selling rates for foreign currencies are determined daily by the Central Bank. As of January 31, 1984, the dinar rate of the U.S. dollar was D 1 = US$1.33369 equivalent to D 1 = SDR 1.28966.

IX. Last Article IV consultation

The last Article IV consultation discussions were held in Tunis during the period March 8-22, 1983, and the staff report (SM/83/100) and the recent economic developments paper (SM/83/118) were discussed by the Executive Board on August 26, 1983. The decision adopted was as follows:

1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Tunisia, in light of the 1983 Article IV consultation with Tunisia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. No significant changes have been made in Tunisia's system of exchange restrictions since the last consultation. The Fund encourages the authorities to ease restrictions on payments and transfers for current international transactions.

The summing-up specified the standard 12-month consultation cycle.

X. Technical assistance

FAD:	Study of planned tax reform (April 18-May 7, 1982)
	Assistance in preparing government financial accounts on a GFS basis (January 11-February 3, 1983)

Financial Relations of the World Bank Group with Tunisia

Date of membership IBRD: April 1958

Capital subscription IBRD: SDR 37.3 million

IBRD/IDA lending operations 1/	Committed		Disbursed	
	IBRD	IDA	IBRD	IDA
	(In millions of U.S. dollars)			
Agricultural and rural development	289.6	8.9	98.0	8.9
Education	65.8	19.4	15.1	19.4
Health	12.5	9.5	0.7	9.5
Energy	112.4	--	59.0	--
Transportation	233.3	16.9	126.5	16.9
Industry and tourism	233.4	10.0	159.3	10.0
Technical assistance	17.9	--	0.2	--
Urban water supply and sewerage	297.0	10.5	134.6	10.5
Total	1,261.9	75.2	593.4	75.2
Repayments	149.1	8.1		
Debt outstanding (including undisbursed)	1,112.8	67.1		
IFC operations (gross commitments)	21.7			

Source: World Bank.

1/ Through the end of February 1984.

Recent World Bank missions:

October 1983: Industrial Employment Creation (Draft report in April 1984).

October 1983: Hydrocarbon Sector Study (Draft report to be discussed in April 1984 with the Tunisian Government).

Tunisia: Selected Economic and Financial Indicators, 1980-84

	1980	1981	1982	1983 Estimates 1/	1984 Official projections
			(Annual percent changes)		
National income and prices					
GDP at constant prices	4.3	5.7	0.3	4.5	5.5
GDP deflator	14.5	11.4	15.9	8.7	7.0
Consumer prices	10.0	9.1	13.6	9.0	7.3
External sector (in SDRs)					
Exports, f.o.b.	18.6	29.1	-17.7	0.6	3.3
Imports, f.o.b.	14.0	21.8	-1.9	-0.8	3.4
Terms of trade (deterioration -)	14.3	6.2	-0.6	-1.6	-1.0
Nominal effective exchange rate (depreciation -) 2/	1.7	3.0	-2.8	-0.7	...
Real effective exchange rate (depreciation -) 2/	-2.1	-0.6	-1.2	-1.3	...
Central government operations (consolidated basis)					
Revenue and grants	18.8	18.0	23.9	10.9 3/	...
Total expenditures and net lending	12.7	17.1	31.6	15.7 3/	...
Money and credit					
Domestic credit	17.6	24.3	23.4	19.7	...
Government	(2.3)	(16.4)	(20.1)	(16.0)	(...)
Economy	(20.5)	(25.6)	(23.8)	(20.2)	(15.0)
Money plus quasi-money	18.6	19.3	18.9	18.7	...
Interest rates					
Discount rate	5.75	7.00	7.00	7.00	...
12-18 month time deposit	5.25	7.00	7.00	7.00	...
General rediscountable advances	7.0-7.5	8.0-8.5	8.0-8.5	8.0-8.5	...
			(Ratios; in percent of GNP unless otherwise indicated)		
Central government consolidated deficit (-)	-2.8	-2.5	-5.0	-6.6 3/	...
Domestic bank financing	(0.1)	(0.9)	(1.1)	(0.9)	(...)
Gross fixed capital formation	27.8	31.7	30.9	29.6	28.2
Gross national savings	24.1	24.7	23.0	20.6	20.8
External current account deficit (-)	-4.8	-7.6	-9.3	-8.7	-7.7
External public debt	35.1	38.2	41.5	45.1	44.5
Debt service/Exports of goods and nonfactor services plus private transfers	12.1	13.7	14.9	16.3	16.5
Gross official international reserves (in months of imports, f.o.b.)	2.5	2.1	2.5	2.5	2.4
			(In millions of SDRs)		
Overall balance of payments (deficit -)	42	35	-22	-41	--
Gross official international reserves (at end of period)	469	467	556	548	548
External public debt	2,322	2,655	2,974	3,238	3,611

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

1/ Official estimates, unless otherwise indicated.

2/ As calculated by staff for purposes of surveillance.

3/ Staff projections at time of previous Article IV consultation mission (March 1983).

1983

1) MR BEVERIDGE
cc: BLUE FOLDER
2) ETR

→ Mr Dale
For approval NR 2/28/

FEB 28 1983

Office Memorandum

CONFIDENTIAL

TO : Managing Director
Deputy Managing Director

February 28, 1983

FROM : J.B. Zulu

SUBJECT: Tunisia--Briefing Paper for Preliminary Discussions on Possible Use of Fund Resources

Attached for your approval, please find the briefing paper for the mission to Tunisia, which is scheduled to leave March 5. It has been cleared by ETR (Mr. Kanesa-Thasan), FAD (Mr. O'Connor), LEG (Ms. Lachman), and TRE (Mr. Wittich). ETR would have liked the Article IV consultation discussions to be held concurrently with the preliminary discussions on the possible use of Fund resources; the last Article IV consultation discussions were held in March 1982 and the Board discussion was in June. On the other hand, at the request of the Minister of Finance and Planning, we intend to separate the two missions, especially because the possible approach by Tunisia to the Fund is considered highly sensitive politically, and the Minister thus wishes to keep the currently proposed mission "low key", and because the pre-mission work for the Fund staff and the Tunisian officials has proceeded on the basis of a mission devoted solely to the exploratory discussions of a possible program with the Fund.

We should like to note that based on official Tunisian projections and data available to the Fund staff, there will likely not be a balance of payments need in 1983 sufficiently large to justify a request for use of Fund resources. However, depending upon subsequent developments in the international economic and financial situation, including importantly those relating to the world petroleum market, such a need could emerge beyond 1983 even with appropriate adjustment measures along the lines indicated in the brief.

Approved, with the following observations;

1. If it is feasible and acceptable to turn the present mission into an Article IV mission in the field there would be advantage:

2. In any event I understand that with the Art. IV discussions scheduled for October, the Board will be able to discuss the Art IV staff report before

Attachment

cc: Mr. Carter

actual negotiations /s/ WBD

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

TUNISIA

Briefing Paper - Preliminary Discussions on Possible Use of Fund Resources

approved

Prepared by the African Department

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by J.B. Zulu and S. Kanesa-Thasan

February 28, 1983

I. Introduction

In a meeting with the Managing Director during the 1982 Annual Meetings, the Tunisian Minister of Finance and Planning expressed an interest in the type of restructuring efforts in the context of the Sixth Development Plan (1982-86) that could qualify for Fund support. This subject was again broached during Mr. François' visit to Tunis in October 1982 in connection with a seminar on the plan. Although the Tunisian authorities have not as yet made a decision to request a Fund arrangement and are reluctant to do so, the Minister has requested a staff visit to discuss the main objectives and policy content of a possible program which could, in the future, be supported by Fund resources. Accordingly, a staff team, consisting of Messrs. François (head), Rothman, Franco, and Sacerdoti and Ms. Elwell (secretary), all of the African Department, will visit Tunis for about two weeks beginning March 8. The team would prepare for the authorities an outline containing the major objectives and policy content of a possible program which could provide the basis for negotiations later in 1983. The mission would closely collaborate with and benefit from extensive studies conducted by the World Bank, especially an in-depth review of the Sixth Plan. The Bank maintains a large project lending program for Tunisia, but has not had any discussions on a possible Structural Adjustment Loan.

As of January 31, 1983, the Fund's holdings of Tunisian dinars amounted to 79.7 per cent of quota. Tunisia continues to avail itself of the transitional arrangements under Article XIV. The last Article IV consultation discussions were held in March 1982, and the Tunisian authorities have expressed a preference for the 1983 discussions to be held in November. Summaries of Tunisia's relations with the Fund and the World Bank Group are contained in Appendices I and II. A table on selected economic and financial indicators is presented in Appendix III.

II. Background

Over the decade ended 1981 the macroeconomic performance of Tunisia was impressive, especially with respect to economic growth and investment. Real GDP grew by about 7.5 per cent per year and on a per capita basis by almost 5 per cent, while capital formation equaled some 28 per cent of GDP. While this performance reflected in large measure rapidly rising petroleum receipts, it was also attributable to improved economic management, including a gradual shift away from centralized government control toward a mixed economy, and relatively prudent financial policies. During the five years 1977-81 the overall budget deficits were modest, amounting to about 3.7 per cent of GDP. The external current account deficits averaged about 7 per cent of GNP and were financed mainly by direct investment and official long-term borrowing, with only limited recourse to financial markets. Overall, during 1977-81 the balance of payments registered a cumulative surplus of SDR 146 million.

Notwithstanding these favorable developments, there have also been a number of disquieting trends. Reflecting rapid population growth and expanded educational opportunities, unemployment remains high; wage increases in recent years have been excessive in both the public sector and private industry, contributing to inflationary pressures and to a decline in the national savings ratio; government subsidies, especially for essential consumer goods, have absorbed an increasing share of public sector resources; generally low interest rates have encouraged consumption and capital-intensive production techniques; and there has been growth of a less-than-efficient public enterprise sector. Despite some relaxation, Tunisia still maintains an extensive system of controls on trade and payments and a comprehensive system of domestic controls which adversely affect trade and production patterns. Moreover, economic prospects for the medium term are less encouraging, as Tunisia's net oil exports are anticipated to decline due to both a rapid rise in domestic demand for energy products and the gradual exhaustion of Tunisia's petroleum reserves, and Tunisia's terms of trade are forecast to deteriorate.

Faced with these trends and prospects, the Tunisian authorities have embarked on a major restructuring effort within the context of the Sixth Development Plan, which is designed to reduce the economy's reliance on petroleum. The strategy aims primarily at raising agricultural production, diversifying the export base, and expanding employment opportunities, while adapting to tighter resource constraints by moderating growth in both consumption and investment. The main structural reorientations include changing the sectoral pattern of investment; encouraging a better choice of production techniques and products through appropriate product and factor prices as well as exchange rate and tariff policies; and reforming the state enterprises. With respect to demand management policies, the authorities are seeking to maintain adequate real growth despite a lower investment rate (26 per cent of GDP, compared with 30 per cent under the Fifth Plan), while strengthening efforts to promote both budgetary and private savings. For the budget, this will entail mainly reducing the scope of subsidies, containing the growth in the wage bill, and expanding the tax base, especially in view of the expected decline in revenues from petroleum exports. To moderate the growth in private consumption, in addition to the tax measures and more appropriate wage policies, interest rate policy and the development of new financial instruments would assume increased importance.

III. Tasks of the Mission

The mission would note the timely fashion in which the authorities are addressing structural weaknesses, especially in view of less encouraging external prospects, and would stress that the Fund would prefer that a member enter into an arrangement early to avoid the emergence of serious financial difficulties. The mission would seek to alleviate fears on the part of the authorities that entering into an arrangement with the Fund early would necessarily have an adverse effect in the international capital markets, to which Tunisia expects to have increased recourse over the next few years. The mission would note that the qualitative objectives and directions of policies contained in the Sixth Plan could form the basis of an extended arrangement.

The Sixth Plan's main quantitative objectives for the 1982-86 period are to maintain an annual growth rate of 6 per cent, while reducing the external current account deficit as a share of GNP by 0.5 percentage point (to 6.6 per cent) compared with the outturn under the previous plan, within the context of a sharp decline in resources from the export of hydrocarbons. The mission would review the feasibility of these targets in view of actual developments in 1982 and prospects for the period 1983-86. In 1982, due to a drought-induced decline in agricultural output and slackened hydrocarbon and phosphate production, growth was only 1.5 per cent, and the current account deficit was equivalent to 7.5 per cent of GNP, compared with 6 per cent in 1981. For 1983, official forecasts are for a 6 per cent growth rate and a current account deficit equal to 7.5 per cent of GNP, but these forecasts were made before the most recent weakening in the world petroleum market. Thus, in view of the shortfalls from targets in 1982 and the continued unfavorable international environment in 1983, it is possible that both the initial growth and current account targets for the 1982-86 period will not be attained.

In any case, the mission will work out with the authorities feasible major quantitative objectives for the period 1984-86. In this connection, the mission would first discuss with the authorities both the medium-term balance of payments outlook and a prudent external borrowing level and maturity structure of new debt such that the medium-term debt service profile would be sustainable. For the Sixth Plan period the authorities had initially anticipated borrowing about SDR 5.2 billion, which, according to the plan's projections, would increase the external debt/GDP ratio only marginally by 1986. This would imply a debt service ratio of about 16 per cent in 1986 provided that receipts from exports of goods and services and private remittances increase by 12.5 per cent per annum. The mission would reassess whether this scenario is still feasible. The recommended policy content of a possible program would be designed to promote maximum growth, adequate savings levels, and external adjustment sufficient to maintain a viable balance of payments and debt posture in the medium term. The major policies would consist of the following, which are discussed in the approximate order of both their importance to adjustment and their sensitivity in the Tunisian sociopolitical context. The mission would state that the implementation of required policy adjustments under an extended arrangement would generally need to be front loaded.

1. Wage policy

Over the period 1981-82 minimum wages in the nonagricultural sector were increased by about 50 per cent, with average rates of remuneration also increasing sharply. In 1982 the increase in the economy's wage bill is officially estimated at 28 per cent--twice the rate of growth in nominal GDP. The staff will stress that further large increases in labor incomes would not be consistent with the plan's objectives. The plan's target of reducing consumption growth as well as promoting exports will not be attainable unless the Government devises an adequate medium-term wage policy. It should be mentioned that industrial relations in Tunisia are particularly difficult, and the authorities would have to convince the labor unions that wage moderation would be in their interest in the longer run. The outcome of the 1983 wage negotiations (currently in progress) will provide a test of the authorities' success in this area.

2. Price policy

Since independence, the Tunisian authorities have maintained an extensive system of price controls. However, beginning in 1981, considerable efforts have been made to introduce some flexibility by permitting the prices of a large number of commodities to be determined freely by market forces and by permitting prices of some other products to be changed with reduced procedural delays. Due largely to both the price liberalization policy and increases in the administered prices of a number of essential commodities, consumer price inflation accelerated to almost 14 per cent in 1982, compared with 9 per cent in 1981. However, in view of this development, the authorities recently appear to have slowed down the price liberalization process. Nevertheless, the staff will urge further progress in this area, as it would provide the economy with proper signals to enhance resource allocation, help reduce the burden of subsidies, and help moderate overall private consumption levels.

3. Monetary and credit policy

The staff would stress that a more active interest rate policy, especially a move to positive real interest rates, and a simpler interest rate structure would enhance a more efficient allocation of resources as well as help mobilize national savings. Based on the officially projected rate of increase in the consumer price index for 1983 (10 per cent) and the present interest rate structure, the real rate of return on one-year time deposits would be about -4 per cent, while the average real cost of commercial bank short- and medium-term rediscountable loans would be about -3 per cent.

During the period of the Fifth Plan the Tunisian authorities tried to maintain the growth in broad money in line with the growth in nominal GDP. This policy was successful in that it permitted the monetary authorities to satisfy the legitimate credit requirements of the economy without causing undue inflationary pressures. In view of the hoped-for continuation of price liberalization, the staff and the authorities will discuss whether this policy should continue to be pursued or whether slower monetary growth should be aimed at. Furthermore, the staff will discuss with the authorities the appropriate mix of public versus private credit, focusing on the sectoral allocation of credit to those areas of the economy which are being encouraged.

4. Fiscal policy

The principal aims of fiscal policy would be to contain the overall fiscal deficit to a level consistent with the stabilization objectives of the program, while mobilizing sufficient resources to finance the investment outlays essential to the program's structural goals. At present, it appears that an overall deficit of slightly under 3 per cent of GDP (the level estimated for 1982) would be appropriate and sustainable, and this would be consistent with the plan's target for government savings of about 8.5 per cent of GNP. The mission will assess carefully revenue projections, particularly in light of the drop in oil-related receipts, and will examine current expenditure projections with a view to limiting these to a level necessary to provide essential economic, social, and administrative services. Central to the discussions will be the need to adequately finance the desired level of investment outlays. Crucial to achieving these goals would be the promotion of a high rate of growth of nonpetroleum related revenues. During the Fifth Plan oil-based receipts accounted for about one quarter of total current budgetary receipts. In 1983 the Government has started to implement the preliminary phase of a tax reform (which has benefited from FAD technical assistance) and to strengthen tax administration. The reform includes revising both personal income taxes and corporate taxes as well as gradually introducing a national value-added tax. The general approach is to reduce overall tax rates, which are currently high compared with those in similar countries, and thereby expand the tax base and reduce fraud. Specific direct tax reductions have already been incorporated in the 1983 budget. The budget projects revenue growth at 12 per cent despite stagnation forecast for petroleum-related revenues. However, in view of the recent weakening in oil prices, the mission would discuss with the authorities whether realization of this projection is feasible. It would also examine with the authorities whether the tax reform, when fully implemented, is likely to be sufficient to ensure adequate revenues over the period 1984-86, and the staff would note that other revenue measures may be required. On the expenditure side the mission would urge that the growth in the wage bill and subsidy outlays be sharply curtailed. In the two-year period 1981-82 the Central Government's wage bill is estimated to have increased by over 45 per cent; total subsidies amounted to about 6 per cent of GDP; and total recurrent expenditure rose at an annual rate of 25 per cent. For 1983, however, the budget calls for a tightening of recurrent outlays in all categories, with only a 12 per cent increase projected. If both this forecast and that for revenue growth are realized, budgetary savings would rise by 10 per cent to 8.6 per cent of GNP. The mission would also review with the authorities the planned government investment level under the Sixth

Plan (almost D 3.7 billion compared with D 1.7 billion under the Fifth Plan) to determine whether some scaling-down may be required in view of the updated projections of overall resource constraints. For 1983 the budgeted increase in capital outlays is modest (16 per cent), and the overall budget deficit should, as in 1982, remain below 3 per cent of GDP.

5. External trade policies

The staff would encourage the authorities to rationalize the system of tariff protection accorded to domestic industries with a view to improving allocative efficiency, to increase the availability of necessary inputs for domestic industries at lower cost through a progressive liberalization of the import system, and to ensure the competitiveness of the export sector and the profitability of export markets relative to the domestic market.

With respect to the exchange rate, the moderate depreciation of the effective rate both in nominal and real terms over the past two years (Appendix III) and the relatively favorable outturns in the external current account suggest that the rate of the dinar is not out of line. However, in view of the objectives of diversifying the Tunisian economy and export base, continued rapid increases in labor costs and other developments may call for further adjustment. In this context, during the last Article IV consultation discussions the authorities reiterated their policy of maintaining export competitiveness by continued use of a flexible exchange rate policy over the medium term. The staff team will encourage the authorities to continue to apply this policy.

6. Reform of public enterprises

The Government participates directly or indirectly in some 300 enterprises, which account for about 25 per cent of GDP and 75 per cent of exports.

Although the number of enterprises dependent on significant budgetary transfers to meet operating losses is limited, the level of transfers, especially for capital expansion, amounted to 21 per cent of total budgetary expenditure in 1981. On the other hand, the contributions of the public enterprises to the Treasury, with the exception of the oil sector, have been insignificant. Over the past few years the Government has conducted several studies of the large enterprises with a view to developing a coherent policy to render them profitable. These studies have revealed that there has been little coordination or cohesiveness in their investment or pricing policies and that there is excessive use of both capital and labor. The staff will examine with the authorities ways to increase the efficiency and profitability of the enterprises and to reduce their burden on the government budget. The Tunisian authorities envisage an enhanced overall performance of public enterprises through improved management in connection with the recent establishment of several new large development banks, which will provide an increased share of public enterprise capital financing.

7. Investment policy

The investment program (which forms the core of the plan), including its sectoral allocation, has been reviewed by the World Bank staff, which, in brief, believes that the overall setting of investment priorities is appropriate. However, they consider that the sectoral investment objectives, the expected increase in employment, and the projected reduction in the capital/output ratio may be difficult to achieve in view of the constraints of absorptive capacity and the need for appropriate incentives for private sector investments. The emphasis is to be placed on labor-intensive activities, agriculture, export-oriented industries, and tourism. While for government investment (which accounts for about 20 per cent of total planned investment compared with 16 per cent during the Fifth Plan period) direct control can in large measure promote the desired allocation, for the private sector (accounting for 32 per cent of planned investment compared with 26 per cent during the previous plan period) and the public enterprise sector (36 per cent compared with 41 per cent in the 1977-81 period) a proper mix of policies is essential to encourage the desired product and factor pattern. These would include a further liberalization of product prices, an increase in the interest rate/wage ratio, liberalizing the trade and restrictive system, and maintaining an appropriate exchange rate. In the discussions, particular attention will be given to agriculture, with an emphasis on the ways to shift the terms of trade to agriculture through the use of adequate producer price policies and the development of adequate extension services.

Fund Relations with Tunisia

Date of membership:	April 14, 1958
Quota:	SDR 94.5 million
Exchange system:	The exchange rate of the dinar is determined in accordance with a basket of currencies. Buying and selling rates for foreign currencies are determined daily by the Central Bank. As of December 31, 1982, the dinar rate of the U.S. dollar was D 1 = US$ 1.624 equivalent to D 1 = SDR 1.472.
Fund holdings:	As of January 31, 1983 the Fund's holdings of Tunisian dinars amounted to SDR 75.3 million, equivalent to 79.7 per cent of quota; there was no use of Fund credit outstanding.
SDR position:	As of January 31, 1983 Tunisia's holdings of SDRs amounted to SDR 16.0 million, equivalent to 46.8 per cent of its net cumulative allocation of SDR 34.2 million.
Gold distribution:	41,066 troy ounces of fine gold
Distribution of profits from gold sales:	US$7.6 million

The last Article IV consultation dicussions with Tunisia were held during the period March 2-16, 1982. The staff report (SM/82/98) and the recent economic developments paper (SM/82/110) were discussed by the Executive Board on June 30, 1982.

Financial Relations of the World Bank Group with Tunisia

Date of membership IBRD: April 1958

Capital subscription IBRD: SDR 37.3 million

IBRD/IDA lending operations 1/	Committed		Disbursed	
	IBRD	IDA	IBRD	IDA
	(In millions of U.S. dollars)			
Agricultural and rural development	248.8	8.9	74.1	8.9
Education	61.6	19.4	4.6	19.4
Population	12.5	9.5	--	9.5
Power and utilities	280.9	10.5	144.0	10.5
Transportation	233.4	16.9	110.2	16.9
Industry and tourism	271.1	10.0	161.2	10.0
Total	1,108.3	75.2	494.1	75.2
Repayments:	118.2	7.2		
Debt outstanding (including undisbursed)	990.1	67.9		
IFC operations (gross commitments)	21.8			

Source: World Bank.

1/ Through the end of December 1982.

Tunisia: Selected Economic and Financial Indicators, 1977-83

	1977-81	1980	1981	1982 Prelim.	1983 Official proj.
	(Annual per cent changes)				
National income and prices					
GDP at constant prices	6.1	4.8	5.0	1.5	6.0
GDP deflator	9.5	14.7	10.9	12.5	9.4
Consumer prices	7.8	10.0	9.0	13.7	10.0
External sector (in SDRs)					
Exports, f.o.b.	21.4	16.6	27.6	-13.4	6.9
Imports, f.o.b.	16.7	15.1	20.4	-4.0	4.7
Terms of trade (deterioration -)	8.2	9.7	7.0	-2.4	-2.0
Nominal effective exchange rate (depreciation -)	-6.6	0.2	0.4	-5.0	...
Real effective exchange rate (depreciation -)	-18.5	-3.0	-2.5	-2.6	...
Central government budget	20.9	19.4	22.1	25.1	11.5
Revenue and grants					
Total expenditures and net lending	18.5	19.3	23.2	23.6	13.7
Money and credit					
Domestic credit	17.4	17.7	24.2	18.4	18.8
Government	15.6	1.9	16.4	14.1	22.0
Private	17.8	20.7	25.4	19.0	18.3
Narrow money (M1)	16.8	21.2	17.4	16.6	16.9
Broad money (M2)	17.5	18.5	19.4	13.9	18.9
Interest rate (discount rate)	6.00	5.75	7.00	7.00	7.00
	(Ratios)				
Central government savings/GNP	8.3	8.4	8.7	9.0	8.6
Budgetary deficit/GDP	3.7	1.8	2.7	2.6	...
Domestic financing/Total financing	65.6	88.4	95.5	109.0	...
Foreign financing/Total financing	24.4	11.6	4.5	-9.0	...
Gross capital formation/GDP	28.2	29.0	32.2	33.0	29.5
Gross national savings/GNP	22.8	24.1	23.9	20.8	21.5
External current account deficit/GNP	7.1	3.7	5.9	7.5	7.5
External debt/GDP	38.8	36.7	39.0	40.0	40.0
Debt service/Exports of goods and nonfactor services plus private transfers	11.8	12.0	14.4	15.2	15.3
Overall balance of payments (millions of SDRs)	146	23	-2	10	10
Gross official reserves (months of imports)	2.0	1.9	1.6	2.0	2.0

INTERNATIONAL MONETARY FUND

February 25, 1983

David:

A copy of my memo is attached for your reference.

I believe that the least that should be done is to let the management know that ETR has raised the question and our reasons.

Attachment

S. Kanesa-Thasan

Office Memorandum

TO : Mr. Finch

February 23, 1983

FROM : J.B. Zulu

SUBJECT: Tunisia--Briefing Paper on Preliminary Discussions on Possible Use of Fund Resources

In reply to Mr. Kanesa-Thasan's memorandum on the above-mentioned briefing paper, we ourselves have given much consideration to conducting the Article IV consultation discussions concurrently with the essentially exploratory discussions on the possible use of Fund resources. However, we have decided against this for the following reasons. First, as far back as the Annual Meeting in Toronto, the Minister of Finance, in the presence of the Managing Director, expressed his preference for the next Article IV consultation discussions to be held in late 1983 (the previous consultation discussions were held in March 1982 and the Board discussion was in June). The Minister has subsequently maintained that he wishes to separate the discussions on the possible use of Fund resources from the consultation discussions, especially as he desires to keep the currently proposed mission "low key", i.e., the possible approach by Tunisia to the Fund is considered highly sensitive politically. The Minister and others would likely have a very negative reaction to being told, at this late date, that the Article IV discussions must accompany the preliminary discussions on the possible use of Fund resources. Second, Management has already approved this particular mission on the current mission schedule. It is also noted that Tunisia was on the list submitted to Management for which an 18-month consultation cycle was recommended. Third, the pre-mission work for the Fund staff and the Tunisian officials has proceeded on the basis of a mission devoted solely to the exploratory discussion of a possible program, and the extra work entailed on both sides to prepare for an Article IV mission less than two weeks before the mission's arrival in Tunis would not seem feasible.

I should hope that these reasons provide sufficient justification for retaining the presently indicated purpose of the mission, with the Article IV discussions to be held as intended in November.

cc: Mr. Kanesa-Thasan

cc. Blue Folder

Office Memorandum

RECEIVED FEB 22 1983 EXCHANGE & TRADE RELATIONS

TO : Mr. Francois DATE: February 22, 1983

FROM : S. Kanesa-Thasan

SUBJECT : Tunisia - Briefing Paper

It is proposed in the brief that the mission will have preliminary discussions on a possible EFF program for CY 1984-1986 and would "prepare for the authorities a memorandum containing the major objective and policy content of a possible program which could provide the basis for negotiations later in (November) 1983, at which time the Article IV consultations are proposed to be conducted.

I think that an Article IV consultation should be held now to evaluate the outlook for 1983 as well as for the medium term, especially in relation to the Sixth Plan (1982-1986). The balance of payments and debt projections in the Plan, in particular, appear optimistic and would require careful scrutiny. The case for a consultation is further strengthened by the fact that the 1982 discussions took place in March 1982. Although the brief states that the Tunisian authorities "have expressed a preference" for the consultations to be held in November 1983, I believe that in the circumstances we should follow a annual cycle of consultation which would precede the discussions on a possible EFF program. This approach would be in accord with the position currently being taken by the management. An early consultation would not only enable the staff to better formulate an EFF program in cooperation with the World Bank, but also to benefit from Directors' views. I might add that Mr. Finch agrees with this recommendation.

Therefore, the brief needs to be altered to require the mission to conduct the 1983 Article IV consultations and also to conduct preliminary discussions on an EFF. Otherwise, the brief can remain essentially the same, with the qualification that the mission should leave the quantitative targets for the EFF period to be finalized in November 1983.

The brief notes that the World Bank considers the Sixth Plan as "ambitious." As you know, the World Bank's evaluation would be important for an EFF program. We should be able to incorporate this in any EFF program, as well as the Bank's input on some other policy areas of structural change (e.g., public enterprise sector, import protection). In view of the several Bank studies referred to, has the Bank had any discussions on an SAL for Tunisia?

The brief does not explain why the exchange rate "may be currently considered appropriate" (page 10). Exchange rate policy would need to be examined in an Article IV consultation.

Finally, two general comments: First, we should not at this stage determine the size of the Extended Arrangement at 450 per cent of quota, but rather leave it open as "upto 450 per cent of quota." Second, I would think that the authorities should be made aware early that the implementation of required policy adjustments under the EFF would need to be generally front loaded.

I have a few other comments on the brief which I would convey verbally.

cc:Mr. Zulu
Mr. Wittich

cc. Mr. Reese, Frédet
Mr. [illegible]

Office Memorandum

TO : Mr. Francois

DATE: February 22, 1983

FROM : Günter Wittich GW

SUBJECT : Tunisia--Briefing Paper for Preliminary Discussion on Possible Use of Fund Resources

The opportunity to discuss the Sixth Development Plan with the Tunisian authorities at an early stage is, of course, to be welcomed. However, I wonder whether it is not somewhat too early to decide the type, and even more the amount, of an arrangement that would be appropriate for 1984 and beyond. The draft briefing paper at any rate does not allow an informed judgement on these questions, and it therefore would seem premature that the "discussions...be premised on the assumption that Tunisia would seek an extended arrangement for the years 1984-86 amounting to SDR 425.25 million, or 450 per cent of quota."

In particular, there do not at present exist any balance of payments difficulties--on the contrary, Tunisia registered surpluses over most of the last five years. It also does not appear to be an economy characterized by slow growth and an inherently weak balance of payments position--growth appears to have been around 6 per cent in recent years, and is planned at 6 per cent per annum during the plan period 1982-86. Further, it is not clear what the resource restraints on Tunisia are, and the relative role to be played by adjustment and by (Fund-) financing.

The draft brief suggests that the Tunisian authorities are seeking Fund advice on the restructuring of their economy, but are reluctant to request--and perhaps are not in need of--financial assistance. We should, of course, offer all the assistance we can in developing a program of structural adjustment necessitated by the anticipated decline of net oil exports. However, in view of the present strain on the Fund's resources, I wonder whether we should actively encourage them to seek an extended arrangement for the maximum allowed under the Guidelines?

cc: Mr. Habermeier
Mr. Kanesa-Thasan
Mrs. Lachman

1982

Office Memorandum

cc: Mr. Beaudoin[?]
Mr. Kanesa-Thasan

TO : Managing Director
Deputy Managing Director

DATE: March 25, 1982

FROM : Ch. A. François

SUBJECT : Tunisia: 1982 Article IV Consultation

A mission consisting of Messrs. Buu Hoan (AFR), R. Franco (AFR), E. Sacerdoti (AFR), A. Tazi (FAD), Mrs. M. Dowsett (secretary-AFR), and myself visited Tunis during the period March 2-16, 1982 to conduct the Article IV consultation discussions. The discussions took place at a time when the principal components of the 1982 government and economic budgets were basically known and when the 1982-86 development plan was at a fairly advanced stage of preparation. They could therefore, be generally forward looking, and they were frank and cordial throughout. Meetings were held with Mr. Mansour Moalla, Minister of Planning and Finance, Mr. Moncef Belkhodja, Governor of the Central Bank, as well as other ministers and senior officials dealing with economic and financial matters.

Tunisia's overall economic and financial performance during the period of the Fifth Development Plan 1977-81 was relatively strong. Stimulated by a high rate of investment, generally good weather conditions, and relatively efficient economic management, Tunisia achieved a relatively high rate of economic growth (6 per cent annually), a rapid expansion in nonagricultural employment (3 per cent annually) and a significant improvement in the general standard of living. As at the same time, world market prices for Tunisia's major exports (petroleum, phosphate products and olive oil) rose sharply, real GDP adjusted for the gains in the terms of trade increased by almost 8 per cent annually. Although real consumption expanded more rapidly than real GDP, domestic savings remained high (at about 20 per cent of nominal GDP) and financed three-quarters of investment. The sharp increase in government revenue, partly due to petroleum earnings, helped to maintain a substantial level of budgetary savings (about 9 per cent of nominal GDP) and to reduce the overall fiscal deficit from 7 per cent of GDP in 1977 to 2.6 per cent in 1981. Monetary expansion during the period remained in line with the rate of growth of nominal GDP. Reflecting these developments, the current account deficit of the balance of payments was halved to 5 per cent of GDP in 1981, and was financed mainly by medium- and long-term public borrowings and direct investment. The external debt outstanding as a proportion of GDP declined from 46 per cent in 1974-77 to 32 per cent in 1981. However, because of heavy borrowing up to 1978 and higher interest rates, the debt service ratio increased from 10 per cent in 1977 to 14 per cent in 1981. Owing to substantial subsidies on essential foodstuffs and petroleum products, the increase in domestic prices was moderate (about 7 per cent) over the period 1977-80, but accelerated to 9 per cent in 1981.

Economic prospects for 1982 appear less favorable. The growth in real GDP is expected to slow down to about 4 per cent because of a stagnation in crude oil production and a shortfall in agricultural production due to insufficient rainfall in early 1982. Following the substantial increase in wages, decided in February 1982 after a period of social unrest (the minimum wage was raised by 33 per cent), domestic consumption is likely to expand more rapidly than in previous years. This together with a partial liberalization of price controls and a reduction of price subsidies is likely to lead to price increases of about 12-14 per cent. As the higher wage payments for civil servants will be offset by higher import tariffs and an increase in excise tax on petroleum consumption, the overall fiscal deficit is projected to increase by only 11 per cent but to remain unchanged as a ratio to nominal GDP. With the deterioration in the terms of trade resulting mainly from the decline in the export price of crude oil, the current account deficit of the balance of payments as a percentage of GDP will widen to about 8 per cent. This deficit will be financed by new foreign borrowing and by direct foreign investment, including foreign participation in five new development banks established in association with other Arab countries.

The general economic prospects for the medium term are likely to become less advantageous. Barring new major oil and gas discoveries, total hydrocarbon production is likely to stagnate over the next few years. With domestic demand continuing to expand rapidly, net export of crude oil will decline rapidly, turning Tunisia into a net importer before the end of the decade. Furthermore, world prices for hydrocarbons are not expected to increase significantly in real terms in the 1980s so that Tunisia's terms of trade might well stagnate or deteriorate. At the same time, the total population of working age is increasing rapidly and a growing share of that population (particularly female and peasants) is seeking salaried employment. Therefore, the number of new jobs would have to increase by at least 4 per cent annually only to absorb new job seekers, without reducing the level of unemployment, presently estimated at about 15 per cent of the total active population. This problem is exacerbated by the marked slowdown in emigration to European countries, the traditional safety valve against unemployment.

Faced with these difficult prospects, the authorities are preparing, in the context of the new Development Plan for 1982-86, a new economic strategy aimed at adjusting the economy gradually to the post hydrocarbon period and at reducing the severe unemployment problems, while preserving a sustainable domestic and external equilibrium. The new strategy aims in particular at reorienting investment toward labor intensive projects and export-oriented industries, increasing agricultural production, and slowing down consumption and related imports. To that end, the authorities intend to restructure the public enterprise sector, increase reliance on private initiative, adopt a more realistic pricing policy (including for petroleum products) and encourage private savings. While in full agreement with this strategy, the mission felt that the objectives set for the period 1982-86 were somewhat ambitious and will require greater efficiency in economic management and strong political determination to contain increases in real consumption. In this connection, the mission stressed the urgent need to reduce consumer subsidies (now equivalent to 4 per cent of GDP) and to implement a comprehensive tax reform which could increase revenue from the non-oil sector and introduce more effectiveness and equity in the tax system. The Minister of Planning and Finance indicated that he intends to request Fund technical assistance in the coming weeks to review a draft reform presently under consideration (a copy is being sent for comments to FAD).

The authorities indicated that they considered the exchange rate policy as an important element in maintaining the competitiveness of Tunisia's manufacturing and tourism sectors. To that end, in March 1981, they revised the composition of the currency basket in order to avoid an undesirable appreciation of the dinar, in particular vis-à-vis the French franc and the currencies of other main trading partners. During 1981, largely as a result of this revision, the nominal import-weighted effective exchange rate of the dinar remained stable. Vis-à-vis the dollar, the dinar recorded a depreciation of 22 per cent. For 1982, the authorities intend to adjust further the currency basket in order to limit the expected appreciation of the dinar in real terms vis-à-vis the currencies of the main partners and competitors following the anticipated marked increase in domestic costs.

Little change has taken place in the trade and payments system since the last consultation. However, a de facto relaxation of restrictions has resulted from a more flexible administration of existing controls and a simplification of import procedures. The authorities reiterated their objective to liberalize further and simplify the procedures for imports and invisible payments, and to rely more on import duties to protect the domestic industries.

While being determined to fully implement the adjustment policies and structural reforms required for a smooth transition of Tunisia into an oil importing economy, the authorities do not exclude balance of payments problems in the next few years if the anticipated large increase in agricultural production and industrial export does not materialize and if the wage and price developments could not be fully controlled. In that context, they inquired informally on the conditions necessary to obtain Fund resources. The mission indicated that use of Fund resources would be subject to the requirement of balance of payments need and to a clarification of Tunisia's hydrocarbon production potential which has been reported recently in the press as being very promising. Furthermore, it would imply the preparation of a comprehensive adjustment program within the framework of the development plan now under preparation but with more specific measures in the area of public finance, public enterprises and exchange rate policies. Several Tunisian representatives felt that in the present circumstances the use of Fund resources could jeopardize Tunisia's good creditworthiness in international financial markets. It was agreed to discuss further this matter toward the end of the year.

The Minister of Planning and Finance informally asks me to convey to you his wish that you visit Tunisia in May following the meeting of the Interim Committee in Helsinki.

cc: CBD
ETR
EXR
FAD
INST
LEG
RES
SEC
STAT
TRE
Mr. Carter

cc: Blue Copy
✓ETR Files

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

TUNISIA

Briefing Paper - 1982 Article IV Consultation

Prepared by the African Department

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, and the Treasurer's Departments)

Approved by J.B. Zulu and S. Kanese-Thasan

February 23, 1982

A mission consisting of Messrs. Ch. A. Francois (head-AFR), Buu Hoan (AFR), R. Franco (AFR), E. Sacerdoti (AFR), Mr. Tazi (FAD) and Mrs. M. Dowsett (secretary-AFR) will visit Tunis during the period March 2-March 16, 1982, to conduct the 1982 Article IV consultation discussions. Summaries of the Fund's and the World Bank's relations with Tunisia are provided in the attached Appendices.

I. Recent Economic Developments

Within the context of the Fifth Five-Year Development Plan (1977-81), the Tunisian authorities pursued an investment program designed in the main to accelerate the rate of economic growth, to increase employment opportunities, and to strengthen the balance of payments. The main objectives of the plan were by and large achieved. During 1977-81 the economy grew at the fast pace of 6.3 per cent annually, compared to the planned target of 7.5 per cent, while the level of employment increased by 12 per cent, about 4 percentage points less than planned.

The high growth rates during the period 1977-81 reflected the sustained expansion in key economic sectors, such as mining, petroleum, and manufacturing as well as tourism, for which annual growth rates ranged between 7 and 12 per cent. Crude oil output increased steadily until 1980, by 9 per cent a year, but declined in 1981. Agriculture and fishing, on the other hand, whose output fluctuated with variations in weather, fared less well with an annual growth of 2.5 per cent. During the plan period investment was on average 30 per cent of GDP, with private investments exceeding plan targets and public investments falling only slightly short of the objectives. The rate of inflation remained stable during 1980 and 1981 at about 10 per cent.

As a result of wage increases since 1977, consumption in real terms increased faster than real GDP during 1977-81 (7.5 per cent per annum versus 6.3 per cent). In nominal terms, however, consumption expenditure grew at a rate somewhat lower than that of GDP (15.4 per cent against 15.8 per cent), as the growth in nominal GDP benefited from substantial gains in the terms of trade resulting from the sharp increase in oil prices between 1977 and 1980, so that the ratio of gross savings to GDP increased steadily, from 18.8 per cent in 1977 to 25 per cent in 1981. Similarly, a lower rate of growth of nominal domestic expenditure than that of GDP resulted in a reduction in the resource gap from 11 per cent in 1977 to an estimated 6 per cent in 1980-81. The rapid rate of expansion of exports of goods and services during 1977-81 (25.1 per cent per year in nominal terms against 23.4 per cent for imports) was the result of higher oil production, the sharp increase in oil prices, and a rapid growth of receipts from tourism and workers' remittances.

During the period since 1977 the financial policies pursued by the authorities were relatively restrained and well balanced. The budgetary deficit as a proportion of GDP declined from a high of 7 per cent during 1977 to 4 per cent in 1980. The improved financial situation of the Central Government resulted mainly from a rapid growth in oil revenue and a lower expansion in expenditure. During the period 1977-80 revenue and grants increased at an annual rate of 20 per cent, while expenditure rose on average by 18 per cent. During 1981, however, this trend was reversed, as the latter is estimated to have risen by 24 per cent and the former by 20 per cent, and the budgetary deficit rose to 5 per cent of GDP. While during the years 1977-78 the Government relied in nearly equal proportions on foreign and domestic financing, since 1979 foreign borrowing was sharply curtailed.

Over the recent years monetary policy has been geared to maintain the rate of monetary expansion equal to that of GDP. The rate of expansion of credit to the Government was considerably reduced in 1980, when public sector deposits with the Treasury surged. However, credit to the economy rose faster in 1980. In 1981 domestic credit expansion rose at a faster rate than in 1980 (22.5 per cent against 17.6 per cent), as the growth in credit to the economy accelerated, partly because of a recovery in the agricultural sector, and growth of credit to the Government also increased as a result of a higher budgetary deficit.

Reflecting an improvement in the terms of trade and an increasingly positive service balance, the current account deficit of the balance of payments improved significantly between 1977 and 1979, declining from 11 per cent of GDP to 4.8 per cent. The rising tourism receipts contributed by

4 percentage points to this improvement. In 1980 the current account deficit increased slightly from the 1979 level, but the deficit was more than covered by net capital inflows so that the overall balance of payments registered a surplus of D 27 million. In 1981 the current account deficit is estimated to have widened to D 315 million, corresponding to 7.7 per cent of GDP, as the terms of trade deteriorated as a result of stable oil prices and the growth in merchandise imports in volume terms outstripped the growth in exports, which was adversely affected by a reduction in petroleum exports. Overall, the balance of payments is estimated to have been in equilibrium, as net capital inflows increased significantly. In the next few years the current account of the balance of payments may weaken, as oil production, which in recent years has contributed over 50 per cent to export earnings, is expected to decline, and Tunisia is likely to become a net importer of energy. At the end of November 1981 Tunisia's gross international reserves stood at US$661 million, equivalent to 2.2 months of 1981 imports. Tunisia's external debt at the end of 1980 amounted to US$2.9 billion or 35 per cent of GDP. The debt service remained broadly stable between 1977 and 1980, equaling about 11 per cent. In 1981 the ratio has risen to close to 13 per cent, as a result of both higher interest payments and larger scheduled amortization.

Since April 1978 the exchange rate for the dinar has been determined on the basis of a basket consisting of the U.S. dollar, the French franc, and the deutsche mark. The nominal effective import-weighted exchange rate index remained broadly stable in 1980 and appreciated by 1.9 per cent in 1981. In view of the relatively moderate inflation rates recorded in Tunisia, the real effective import-weighted exchange rate depreciated by about 1.5 per cent in

1980 and by a further 0.6 per cent in 1981. Tunisia maintains a relatively complex exchange and trade system. Although little progress has been made toward achieving a formal liberalization of the exchange and trade system, some relaxation of restrictions has resulted from a more flexible administration of existing controls in recent years.

II. Topics for Discussion

Notwithstanding the good economic and financial performance over the period 1977-81, Tunisia is facing a number of economic problems which might weaken the performance during the 1980s. These include the high level of unemployment, the extensive system of price controls and subsidies, and the continued dependence of a number of public enterprises on the budget for financing. Furthermore, the emerging downward trend in oil production, coupled with an increase in domestic energy consumption, is expected to turn Tunisia into a net oil importer by the end of the decade, unless new reserves are discovered. It is to address these problems that the authorities have formulated the Sixth Five-Year Development Plan (1982-86). Accordingly, the authorities are mounting a major investment effort to diversify the production base of the economy. The level of overall investment is anticipated to be US$20 billion, or twice that achieved under the Fifth Plan. The emphasis is on developing tourism and export-oriented industries further while giving the agricultural sector a higher priority than in the past. To enhance the efficiency of financial intermediation and avoid imposing undue pressures on the budget, the Tunisian authorities are expanding the role of the banking system in financing development expenditures through the creation of large development banks. In this overall context, the mission will focus its discussions on the following main issues:

1. The mission will review recent production developments in the major sectors and discuss the outlook for economic growth in 1982, with specific reference to the output prospects for the principal exports and for agricultural crops. Pertaining to medium-term prospects, the Government's policy to diversify the economy will be examined, and the main sectorial investment targets will be reviewed and their likely impact on employment, production, and exports will be ascertained. The overall strategy for financing investments will be discussed in the context of the plans' assumptions regarding domestic savings forecast and envisaged foreign borrowing.

2. The mission will assess the financial situation of public enterprises and, in particular, the prospect for achieving the current plan's targets for public enterprises' savings and investment. It will also review their relative economic efficiency as well as the efforts initiated to encourage greater participation in the enterprises by the private sector. In addition, the staff will evaluate the extent to which the financial performance of the enterprises is expected to be affected by government policies related to procedures for wage adjustments, tariffs, and price controls, and will analyze the role of fiscal incentives and budgetary assistance to finance investment. In examining the incidence of price controls and the large subsidies which accompany them, the staff will focus its attention on existing price-cost distortions and on the financial status of the Price Stabilization Fund (PSF).

3. The mission will review recent fiscal developments. The budgetary outcome for 1980-81 and estimates for 1982 will be discussed. On the revenue

side, the mission will review the responsiveness of fiscal receipts to changes in domestic income, as well as the authorities' intentions with regard to changes in taxes and improvements in tax administration with a view to increasing revenue. On the expenditure side, policies will be analyzed, and priorities with reference to the main components of expenditure growth will be discussed. The overall financing requirement of government operations, in the context of weakening oil revenues, will be assessed, and its implications for monetary stability and the foreign debt sitution will be analyzed.

4. The mission will review recent trends in monetary aggregates and prospects for 1982-83. Domestic credit policies will be discussed in the context of financing needs of the public and private sectors and of the balance of payments and price objectives. The staff will also inquire into the steps undertaken or contemplated to tap domestic liqudity for investment purposes and to stimulate savings; in this context the authorities' interest rate policy will be re-examined. Furthermore, the staff will evaluate the progress made by the monetary authorities in monitoring the activities of public enterprises and by the new development banks in assuming a larger burden of investment expenditure.

5. The balance of payments outcome for 1981 and detailed estimates for 1982 and projections for 1983 will be discussed. In particular, export trends and prospects will be reviewed by focusing on the expected volume and price of Tunisia's main export commodities. Import developments and forecasts will be analyzed in terms of the country's requirements for capital and consumer goods. The prospects for tourist receipts and workers'

remittances will be assessed. With regard to the medium term, the mission will discuss with the authorities the policies to cope with the prospective deterioration in the current account as the country becomes a net importer of energy. These policies, which should be directed to promote exports by a coordinated system of incentives involving measures regarding export credits, the degree of protection of the domestic market, the tariff structure and the like, are also the object of a World Bank study. The policies regarding the extent and nature of foreign borrowing in 1982 and in the medium term will also be examined and discussed. The mission will emphasize the need to channel such borrowing into productive export-oriented investment projects to sustain the balance of payments in the medium term. Furthermore, the mission will stress the need to maintain the overall debt and its servicing burden within manageable limits.

6. The present system of determining exchange rates and its underlying rationale, as well as the appropriateness of the current valuation of the dinar in the context of Tunisia's medium term balance of payments outlook and its effort to encourage new export industries, will be discussed. The mission will update information on the foreign exchange and trade system and will ascertain the progress, if any, the authorities have made since the last consultation toward further liberalization and simplification of the existing system. In this contex, the mission will again stress the potential benefits that the economy would derive from a more substantial liberalization of the system of restrictions.

Fund Relations with Tunisia

Date of membership:	April 14, 1958
Quota:	SDR 94.5 million
Exchange system:	Since April 1978 the exchange rate for the dinar has been determined on the basis of a basket consisting of the U.S. dollar, the French franc, and the deutsche mark. As of January 29, 1982, the dinar rate of the U.S. dollar was D 1 = US$1.89, equivalent to D 1 = SDR 1.65.
Fund holdings:	As of January 29, 1982, the Fund's holdings of Tunisian dinars amounted to SDR 75.3 million, equivalent to 79.7 per cent of quota.
SDR position:	As of January 29, 1982, Tunisia's holdings of SDRs amounted to SDR 17.4 million, equivalent to 50.9 per cent of its net cumulative allocation of SDR 34.2 million.
Gold distribution:	41,066 troy ounces of fine gold.
Distribution of profits from gold sales:	US$7.6 million

The last Article IV consultation discussions with Tunisia were held in Tunis during the period October 31-November 15, 1980. The staff report (SM/81/22) and the recent economic development paper (SM/81/33) were discussed by the Executive Board on March 6, 1981.

Financial Relations of the World Bank Group with Tunisia

Date of membership IBRD: April 1958

Capital subscription IBRD: SDR 37.3 million

IBRD/IDA lending operations 1/	Committed IBRD	Committed IDA	Disbursed IBRD	Disbursed IDA
	(In millions of U.S. dollars)			
Agricultural and rural development	194.6	8.9	68.6	8.9
Education	36.6	19.4	1.9	19.4
Population	15.0	9.6	2.5	8.2
Power and utilities	239.8	10.5	120.7	10.5
Transportation	207.7	11.7	99.0	11.7
Industry and tourism	200.0	10.0	106.8	10.0
Total	891.7	70.1	399.5	68.7
	IBRD	IDA		
Repayments:	88.3	5.8		
Debt outstanding (including undisbursed)	803.4	64.3		
IFC operations (gross committments)	21.8			

Source: World Bank.

1/ Through the end of September 1981.

cc: Mr. Karese-Hasan

Office Memorandum

TO : Managing Director
Deputy Managing Director

DATE: November 17, 1980

FROM : Saleh Nsouli

SUBJECT : Tunisia--Article IV Consultation Discussions

A mission consisting of Mr. R. Franco (AFR), A. Steinherr (CBD), Z. Ebrahim Zadeh (AFR), L. Doe (FAD), Ms. M. Paris (secretary-AFR), and myself visited Tunis during the period October 31 to November 15, 1980 to conduct the 1980 Article IV consultation discussions. The mission was accorded a very warm reception and had comprehensive and cordial discussions with the authorities, who expressed a keen interest in cooperating closely with the Fund. The Tunisian team comprised Mr. Mansour Moalla, Minister of Planning and Finance, Mr. Moncef Belkhodja, Governor of the Central Bank, Mr. Azouz Lasram, Minister of National Economy, as well as a number of other senior officials dealing with economic and financial matters.

Within the context of the Fifth Five Year Development Plan (1977-81), the Tunisian authorities pursued actively during 1977-80 an investment program designed in the main to accelerate the rate of growth of the economy, to increase employment, and to strengthen the balance of payments position of the country. The main objectives of the Plan were largely achieved. During 1977-80 the economy grew at a fast pace, averaging about 7 per cent per year, the level of employment increased by about 12 per cent, and, in part due to sharp increases in the price of its oil exports, in its receipts from tourism, and in workers' remittances, the current account deficit was narrowed from about 8.6 per cent of GDP in 1976 to about 3.3 per cent in 1980. With the exception of 1977, the deficits on the current account were more than offset by surpluses on the capital account. During this period, the financial policies pursued were relatively restrained and well balanced. The budgetary deficit was reduced from about 7 per cent of GDP in 1977 to about 2 per cent in 1980, while the rate of growth of monetary expansion was limited to that of nominal GDP, which grew annually by about 17 per cent. Reflecting these factors, as well as an extensive system of price controls and subsidies, the recorded average annual rate of inflation as measured by the consumer price index was limited to about 8 per cent during this period.

The economy is expected to continue growing at about the same pace during 1981. Preliminary budgetary estimates indicate a widening in the budgetary deficit, partly due to a levelling off in the growth of oil revenues and a substantial expansion in capital expenditures. However, in the light of past experience, the actual budgetary deficit for 1981 could turn out to be lower with actual revenues higher and expenditures lower than provided for in the preliminary estimates. The rate of growth of domestic liquidity is expected to slow down somewhat, reflecting a projected unchanged level of net foreign assets and a lower rate of credit expansion. In the external sector, the current account deficit is anticipated to increase, in part due to a more limited rise in oil revenues than in previous years. However, the overall balance of payments position is expected to be in balance, due to a projected surplus on the capital account.

.../...

Notwithstanding the relatively successful implementation of the Plan, there are a number of economic problems preoccupying the authorities. These include a high level of unemployment, the dependence of public enterprises on the budget for financing, the effects of an extensive system of price controls and subsidies, and an emerging downward trend in oil production. The latter development, coupled with an increase in domestic energy consumption, is expected to turn Tunisia from a net oil exporter into a net oil importer in the second half of this decade, unless new reserves are found.

It is against this background that the authorities are in the process of formulating the Sixth Five Year Development Plan (1982-1986), which is viewed as providing the basis for the transition of Tunisia into a net oil importing economy. Accordingly, the authorities intend to mount a major investment effort during the Sixth Plan Period to diversify further the production base of the economy. The level of overall investment is anticipated to be twice that achieved during the Fifth Plan. The emphasis is expected to be on developing further tourism and export-oriented industries, while giving the agricultural sector a higher priority than under the previous Plan. The authorities are also stressing the need for balanced regional development, and intend to provide incentives for industries to locate outside urban centers. The level of investment envisaged during the Sixth Plan is anticipated to generate enough employment to absorb the rapidly expanding labor force and contribute to reducing somewhat the current rate of unemployment.

With the coming into power of a new team of economic policy makers in 1980, headed by the Minister of Planning and Finance, a major shift in the orientation of economic policies can be expected to be felt during the Sixth Plan period. For a number of years, the role of the public sector in economic activity had been increasing, with the result that in 1980 public enterprises contributed about one third of value added to GDP, while the influence of the Government on the economy through price controls and subsidies was pervasive. The Tunisian authorities envisage what they term "an improvement in the efficiency of Government involvement in economic activity". In this regard, the Government is encouraging a greater participation by the private sector in economic activity while continuing to undertake investments in major projects. For this purpose, four new investment banks are being set up, three of which include French, Kuwaiti, and Saudi Arabian participation, to provide financing for new investment projects. Furthermore, the Tunisian government is currently reviewing the financial situation of public enterprises, many of which have been suffering from declining profitability and productivity trends, with a view to determining ways and means to improve their performance. The authorities indicated that the gradual turning over to the private sector of some public enterprises could be envisaged, although they noted that this would depend on a number of considerations, some of which were of a social nature. In line with the new policy orientation, it is the intention of the authorities to reduce in a very gradual manner the scope of price controls and of subsidies. In addition, the Tunisian authorities are committed to continue easing restrictions on external transactions, a process which, they hope, will encourage foreign investment.

The Tunisian authorities are currently reviewing a number of policy issues. In order to compensate for declining oil revenues, they are studying measures for improving the efficacy of tax administration and are considering the restructuring

.../...

of the present tax system. The Tunisian authorities also intend to undertake a study on the effects of raising interest rates from their current relatively low levels. In addition, the authorities plan to undertake a study on the appropriateness of continuing with their present exchange rate system, which involves the pegging of the exchange rate of the dinar to a basket of currencies consisting of the US dollar, the French franc, and the Deutsche mark. They expressed an interest in keeping in touch with the Fund in connection with these studies.

The Minister of Planning and Finance noted that Tunisia had had a current account deficit for a number of years, that the surplus on the balance of payments was expected to disappear and an overall balance of payments deficit was likely to emerge after 1981. He added that, in the event that a balance of payments need should emerge, the Tunisian authorities may approach the Fund to discuss possible use of resources.

The mission discussed with the authorities the desirability of accepting the increase in quota under the Seventh Review. During the stay of the mission, the Council of Ministers approved the increase in Tunisia's quota to SDR 94.5 million and sent the recommendation to the Senate which is expected to act on it toward the end of this month.

cc: CBD
ETR
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Mr. Watson

FOR BLUE FOLDER

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

TUNISIA

Briefing Paper - 1980 Article IV Consultation

Prepared by the African Department

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, and the Treasurer's Departments)

Approved by J.B. Zulu and S. Kanesa-Thasan

October 17, 1980

A mission consisting of Messrs. S. Nsouli (head-AFR), R. Franco (AFR), Z. Ebrahim-Zadeh (AFR), A. Steinherr (CBD), L. Doe (FAD), and Ms. M. Paris (secretary-AFR) will visit Tunis during the period October 31-November 14, 1980, to conduct the 1980 Article IV consultation discussions. Summaries of the Fund's and the World Bank's relations with Tunisia are provided in the attached Appendices.

I. Recent Economic Developments

Within the framework of a Five-Year Development Plan covering the period 1977-81, the Tunisian authorities have pursued an active investment program designed in the main to accelerate the rate of economic growth, generate new jobs to absorb the expanding labor force, and strengthen the balance of payments position of the country. During 1977-79, the capital formation target was nearly attained, with annual investment expenditure averaging about 26 per cent of GDP, approximately two thirds of which was financed by domestic savings. Reflecting partly the high level of capital formation, the Tunisian economy has grown at a fast pace. During 1977-79 annual real GDP growth averaged about 6 per cent, and is projected to average close to 8 per cent annually during 1980-81. The overall annual growth rate for the plan period is projected at about 6.6 per cent, compared with a target of 7.5 per cent. While the mining (primarily phosphates), manufacturing, and tourism sectors grew rapidly, the rate of growth of the agricultural sector lagged behind, mainly due to fluctuations in weather conditions. Employment opportunities increased by about 14 per cent during 1977-80, close to the Plan's target. Furthermore, to the extent that nominal GDP expanded at a faster pace than gross domestic expenditure, the domestic resource gap as a proportion of GDP declined from over 10 per cent in 1977 to an estimated 7 per cent in 1980.

Notwithstanding the relatively successful implementation of the Plan, two major problems have been a source of concern. First, the above noted rapid increase in employment opportunities under the current plan lagged behind the expansion of the labor force, with the result that the level of unemployment, which was already high, was increased further. It was estimated by the Tunisian Government to have risen from 14 per cent in 1976 to 16 per cent in 1979. The rise in unemployment has been attributed to the entry into the labor force of the youth born during a baby boom in the 1960s, greater participation of women in the work force, and a decline in the emigration of workers. In addition, the growth in employment opportunities has been constrained by the emphasis given to investment in capital intensive industries. Second, the public enterprises, which were expected to contribute significantly to domestic savings, have had to rely increasingly on the Treasury and foreign borrowing to finance their investment. There are indications that the profitability of public enterprises has been adversely affected by rising input costs, particularly wages, inadequate adjustments in output prices, and unsatisfactory productivity trends.

The Tunisian authorities maintain comprehensive controls on the prices of goods and provide subsidies, through the Caisse Générale de Compensation, on a number of essential commodities, such as bread, some cereal-based goods, and edible oil. Accordingly, the recorded rate of inflation in Tunisia does not fully reflect actual inflationary pressures. These, however, have been moderate, insofar as the growth of the economy in recent years has provided for satisfactory supply conditions, while the financial policies pursued have been generally well balanced. Furthermore, in view of declining productivity trends since 1977, the Government has attempted to take into account changes in productivity in adjusting wages for cost-of-living increases. As a result, wage increases during 1978-80 were moderate. The rise in the consumer price index averaged an annual rate of about 6.5 per cent in 1977-78 but is estimated to have accelerated to about 8 per cent in 1979-80 due to a reduction in subsidies and changes in the level of official prices.

Fiscal policy in Tunisia has been relatively restrained in recent years, with the overall central government deficit being maintained at about 4 to 5 per cent of GDP. During 1979 there was a marked improvement in the budgetary position of the Government. The overall deficit dropped to about 3.5 per cent of GDP, as government revenues rose sharply, reflecting primarily increased oil revenues, while the growth rates in current and capital expenditures (including transfers and loans to public enterprises) were limited to 15 per cent and 7 per cent, respectively. Provisional data for 1980 indicate a widening in the budgetary deficit to about 4.2 per cent of GDP, due, in large part, to a substantial slowdown in the growth of oil revenues, reflecting a tapering off in oil price increases, and to a sharp expansion in capital expenditures. Net lending and capital transfers to public enterprises have been on the rise, accounting in 1980 for about 20 per cent of total government expenditures and for about half the capital expenditures. The overall deficit for 1980 was projected to be financed almost totally (about 90 per cent) domestically, in large part through bank financing.

Monetary policy in Tunisia has been generally governed by the objectives of providing adequate credit to finance the needs of public and private enterprises at relatively low interest rates, with a view to maintaining a high rate of economic growth, while limiting the overall rate of monetary expansion in order to contain the emergence of excess demand pressures. The rate of growth of domestic liquidity accelerated from 13 per cent in 1977 to an annual rate of about 18 per cent in 1978-79, primarily due to a sharp rise in the net foreign assets of the banking system. The growth rate of domestic credit decelerated as the rate of growth of private sector credit dropped from about 16 per cent in 1977 to an annual average of about 12 per cent during 1978-79 while the growth of net credit to the Government stabilized. During 1980 the rate of growth of domestic credit is anticipated to accelerate, partly to finance the increased budgetary deficit and to provide credit for private and public enterprises to sustain the growth momentum. However, as net foreign assets are projected to remain virtually unchanged, the rate of growth of domestic liquidity is expected to decelerate to about 12 per cent in 1980.

The balance of payments position of Tunisia improved substantially during 1979, recording an overall surplus of SDR 106.8 million. Export receipts grew by 52 per cent, reflecting the increase in oil export prices as well as a marked rise in receipts from textiles, phosphoric acid, and industrial products. As imports increased by an almost equal absolute amount, the deficit on the trade balance declined only marginally. However, receipts on the service account rose sharply reducing the deficit on the current account to 12 per cent of GDP from 18 per cent in the previous year. This was accompanied by a rise in the capital account surplus, due in part to a near doubling in net direct investment. For 1980 the rise in imports is expected to outweigh the growth in exports, while the growth in service receipts is expected to moderate. As a result, the current account deficit is anticipated to rise by about 10 per cent but to remain virtually unchanged as a proportion of GDP. With a projected decline in the surplus on the capital account, partly due to a retrenchment in net foreign borrowing, the balance of payments is expected to be in equilibrium. At end-May 1980 Tunisia's international reserves were equivalent to about 3 months of imports at the estimated 1980 level.

Tunisia's outstanding public indebtedness rose by only 11 per cent during 1979 to SDR 2.2 billion, following increases of about 28 per cent yearly during 1977-78. In 1980 external public indebtedness is projected to increase by 10 per cent to SDR 2.4 billion. Reflecting the slowdown in the rate of increase in Tunisia's external debt, combined with a strong export performance, the ratio of debt service payments to exports of goods and services has been declining and is projected at about 10.5 per cent for 1980.

Since April 1978 the exchange rate for the dinar has been determined on the basis of a basket consisting of the U.S. dollar, the French franc, and the deutsche mark. The nominal effective import-weighted exchange rate index declined in 1979 by about 2 per cent and by a further 1.5 per cent during the first half of 1980. In view of the relatively moderate inflation rates recorded in Tunisia, the real import-weighted exchange rate index declined by about 7 per cent in 1979 and by an estimated further 4 per cent in the first half of 1980.

Tunisia maintains a relatively complex exchange and trade system. Although little progress has been made toward achieving a formal liberalization of the exchange and trade system, some relaxation of restrictions has resulted from a more flexible administration of existing controls in recent years.

II. Topics for Discussion

While economic developments in Tunisia during 1979-80 were generally favorable, the main task ahead of the authorities, as they formulate the next Five-Year Development Plan, is to gear economic and financial policies to sustain the high growth rates achieved in recent years, redirect investment into more labor intensive projects to generate greater employment opportunities, and increase the productivity of public enterprises. Investment policy will have to take into account the expected decline in oil output in Tunisia toward the end of this decade.

Against this background, the mission will review with the authorities recent investment and production developments and prospects. The staff will discuss the authorities' policies to increase the stability and growth of the agricultural sector, to raise the productivity of the manufacturing sector, and to expand the tourism sector. The main sectoral investment targets envisaged under the new Five-Year Plan will be reviewed, and their likely impact on employment, production, and exports will be ascertained. The World Bank is currently participating in a number of projects which are expected to be completed under the new plan. These include projects for rural electrification, gas distribution, health care, vocational training, and urban development.

The mission will discuss recent price and wage developments. The authorities' pricing and incomes policies will be reviewed in the context of the Government's social and economic objectives, and the impact of these policies on the financial position of the public sector will be examined.

The mission will attempt to assess the financial situation of the public enterprises. It will discuss with the authorities the economic efficiency of these enterprises and the extent to which their financial performance is expected to be affected by government policies related to wage adjustments, direct price controls and subsidies, and the role of fiscal incentives and budgetary assistance to finance investments.

The mission will review recent fiscal developments. The budget estimates for 1981 will be discussed. On the revenue side, the mission will review the responsiveness of domestic revenues to income growth, as well as the authorities' intentions with regard to changes in taxes and improvements in tax administration with a view to increasing revenues. On the expenditure side, expenditure policies will be analyzed, and priorities with reference to the main components of expenditure growth will be discussed. The implications of the overall financing of government fiscal operations for monetary stability and the foreign debt situation will be assessed. The mission will inquire about the medium-term measures contemplated by the authorities to reduce the budgetary deficit.

The mission will review the recent trends in monetary aggregates and the prospects for 1981. The interest rate policy being pursued will be discussed, and its implications for savings, investment, and resource allocation will be assessed.

Recent balance of payments developments and detailed projections for 1981 will be discussed. In particular, export trends and prospects will be reviewed by focusing on the expected volume and price of Tunisia's main export commodities. Import developments and forecasts will be analyzed in terms of the country's requirements for capital and consumer goods. The prospects for tourist receipts and workers' remittances will be assessed. The authorities' policies with regard to the nature of foreign borrowing in 1981 and in the medium term will be examined. The staff team will also appraise the debt service payments in light of the balance of payments prospects over the medium term. The adequacy of the present level of official reserves will also be discussed.

In accordance with the principles of surveillance, the staff will discuss the objectives of the exchange rate policy which Tunisia has followed, and the effect of this policy on the economy, especially on the growth of the export sector and on import substitution.

The mission will review the trade and payments system, and will ascertain the progress the authorities have made or intend to make toward simplifying the present system. The staff will recommend further simplification of the trade and payments system and stress the potential benefits that the economy would derive from a more substantial liberalization of the system of restrictions.

Since Tunisia has not yet consented to the proposed quota increase under the Seventh Review, the mission will enquire about the progress made in consenting to the increase and will discuss the implications of not having consented to the increase when the increase in quotas enters into effect.

Fund Relations with Tunisia

Date of membership:	April 14, 1958
Quota:	SDR 63 million (proposed: SDR 94.5 million--not consented)
Exchange system:	Since April 1978 the exchange rate for the dinar has been determined on basis of a basket consisting of the U.S. dollar, the French franc, and the deutsche mark. As of September 30, 1980, the dinar rate of the U.S. dollar was D 1 = US$2.47, equivalent to D 1 = SDR 1.88.
General department position:	As of September 30, 1980, the Fund's holdings of Tunisian dinars amounted to SDR 51.7 million, equivalent to 82.1 per cent of quota.
SDR position:	As of September 30, 1980, Tunisia's holdings of SDRs amounted to SDR 19.7 million, equivalent to 71 per cent of its net cumulative allocation of SDR 27.8 million.
Gold distribution:	Tunisia acquired 41,066 troy ounces of fine gold in the first four phases of distribution.
Distribution of profits from gold sales:	US$7.6 million

The last Article IV consultation discussions with Tunisia were held in Tunis during the period February 28-March 13, 1979. The staff report (SM/79/123 and SM/79/123, Correction 1) and the recent economic developments papers (SM/79/156 and SM/79/156, Correction 1) were discussed by the Executive Board on July 18, 1979.

Financial Relations of the World Bank Group with Tunisia

Date of membership IBRD: April 1958

Capital subscription IBRD: SDR 37.3 million

IBRD/IDA lending operations 1/	Committed		Disbursed	
	IBRD	IDA	IBRD	IDA
	(In millions of U.S. dollars)			
Agricultural and rural development	99.8	8.9	49.3	8.9
Education	8.6	19.4	0.3	19.4
Population	--	9.6	--	7.4
Power and utilities	165.0	10.5	80.7	10.5
Transportation	169.0	16.9	76.9	16.9
Industry and tourism	143.7	10.0	120.8	10.0
Total	586.1	75.3	328.0	73.1
	IBRD	IDA		
Repayments:	66.1	4.90		
Debt outstanding (including undisbursed)	520.0	70.4		
Commitments July 1, 1969-June 30, 1980	171.0	--		
IFC operations	14.5			

General economic update mission, May-June 1980; irrigation project mission, November-December 1979; review mission on the electrical and mechanical industries, February-March 1979.

Source: World Bank.

1/ Through the end of August 1980.

1979

Office Memorandum

cc: Mr. Kawesa-Tlasa

TO : Managing Director
Deputy Managing Director

DATE: March 21, 1979

FROM : Ch. A. François

SUBJECT : Tunisia--Article IV Consultation Discussions

A mission consisting of Mrs. M. Tyler (ETR), Mr. J. Hill (AFR), Mr. H. Horie (AFR), Mrs. M-J. Bauer (secretary-AFR), and myself visited Tunis during the period February 28 to March 13, 1979 to conduct the 1979 Article IV consultation discussions. The mission was most cordially received and had frank and comprehensive policy discussions with Mr. Mohamed Ghenima, the Governor of the Central Bank, and with Mr. Abdelaziz Mathari, the Minister of Finance, as well as with other Ministers and senior officials dealing with economic and financial matters. The mission's assessment of Tunisia's economic and financial developments and policies was set out in a memorandum which was discussed with the authorities during the concluding meetings.

Following a marked deterioration in 1977, Tunisia's economic and financial situation improved significantly in 1978. As a result of a recovery in agricultural production and a continued expansion in the petroleum, manufacturing, construction, and tourism sectors, real GDP rose by almost 9 per cent, as compared with 4 per cent in 1977. At the same time, the rate of increase in investment, especially in the public sector, began to slow down as the Government delayed the execution of certain major natural gas projects. Although the growth in consumption accelerated following the recovery in agricultural production and upward adjustments in both producer prices and minimum wages, the rate of increase remained below that of GDP and the rate of domestic saving increased noticeably. Owing to substantial subsidies on essential foodstuffs and petroleum products, domestic prices increased only moderately (6 per cent). With practically no change in the external terms of trade, the resource gap as a percentage of GDP declined from 10 per cent in 1977 to about 9 per cent in 1978.

Government receipts rose by 20 per cent, mainly as a result of the economic expansion and new taxes on imports. The growth in current expenditure, especially for higher price subsidies and rising wages and salaries (the second tranche of increases under the 1977 social contract), absorbed virtually all of the increase in revenues. With lower capital expenditure and net lending to state enterprises for their investment, the overall fiscal deficit declined by one fourth to D 116 million (5 per cent of GDP). About half of this deficit was financed from abroad and included a loan from the international financial market (US$150 million). The remainder was financed mainly by the sale of long-term bonds to commercial banks and public entities.

The financial situation of the public enterprise sector generally improved in 1978 following the improvement in production and productivity, smaller increases in wages and costs, and selective increases in both domestic and external prices. Nevertheless, the saving capacity of public enterprises remained weak when compared with their overall investment programs and they continued to rely heavily on budgetary assistance, foreign borrowing, and recourse to domestic bank financing. In 1978 net domestic credit rose by 18 per cent (compared with 14 per cent in 1977), with net claims on government rising more rapidly than credit to the private sector. This expansion, together with an increase in net foreign assets, caused the stock of money and quasi-money to grow faster (20 per cent) than nominal GDP (15 per cent).

After having recorded increasing deficits during the period 1975-77, in 1978 Tunisia's overall balance of payments showed a surplus of SDR 26 million. Despite generally unfavorable conditions in external markets, in particular the EEC restrictions on textile imports, and technical problems in the production of phosphate rock, export earnings increased by 10 per cent, mainly because of higher export volumes of petroleum, olive oil and manufactures. The growth in imports declined to 8 per cent (18 per cent in 1977) reflecting mainly a smaller rate of increase in raw materials and consumption goods. With higher net receipts from tourism and workers' remittances, the current account deficit remained virtually unchanged at SDR 430 million. As this deficit was more than covered by a higher level of net capital inflow, the level of gross official reserves rose to SDR 346 million by the end of 1978, or the equivalent of 2 months of 1978 imports of goods and services.

Economic prospects for 1979 remain broadly favorable. The growth of real GDP is likely to be at least 7 per cent and could be higher if weather conditions continue to be good. This growth will also be supported by continued expansion in the petroleum, manufacturing, construction and tourism sectors and by a recovery in production of phosphate rock. At the same time, the authorities intend to slow down the rate of increase in investment and in consumption so as to contain the growth in both the current account deficit of the balance of payments and the external debt. Furthermore as the increase in the cost of living in the last twelve months was below 5 per cent, the authorities expect that the wage increases to be negotiated in April 1979 will be moderate.

In 1979, the overall fiscal deficit is expected to increase by about 50 per cent to D 173 million. With no new revenue measures, receipts are expected to grow roughly in line with nominal GDP (12 per cent). At the same time, primarily reflecting public wage increases, higher price subsidies and rising interest payments on the public debt, current expenditures are to increase by 17 per cent, leaving the level of current budget savings practically unchanged. Although the growth in direct government investment is expected to remain moderate, net lending to public enterprises is budgeted to rise as part of an effort to make up for the delays in project implementation in 1978. One half of the larger overall deficit is to be financed by foreign borrowing, and a major part of the domestic financing will be obtained from the banking system, mainly in the form of a drawdown of government deposits at the Central Bank and sales of long-term bonds to the commercial banks. To stem the weakening of the fiscal position and to avoid a downward revision of the Government's investment target, the authorities stated that they would seek to reduce price subsidies by raising retail prices in connection with the wage increases expected in April 1979. Based on a forecast that the growth of broad money would be equal to that of nominal GDP and on an objective of achieving a small increase in gross official reserves, the authorities will limit the expansion of overall domestic credit in 1979 to about 16 per cent and that of credit to the private sector to about 14 per cent.

In 1979 the current account deficit of the balance of payments is forecast to increase by 6 per cent; as a percentage of nominal GDP, it will decline to less than 9 per cent. Export receipts are projected to grow at a more rapid rate (13 per cent) than in the previous year, mainly due to higher export volume and prices of petroleum and phosphates. Although import payments are expected to rise at a slower rate (11 per cent) than that of exports, their absolute increase will exceed the rise in exports so that the trade balance will widen further. However, this deterioration will be partly offset by higher tourism receipts and workers' remittances. The net foreign borrowing needed to finance the current account deficit, excluding direct investment and short-term capital, would be SDR 420 million, of which two-thirds will be contracted by public enterprises. Consequently, Tunisia's outstanding official external debt is expected to rise by one fifth, with more than half of the increase being mobilized from private sources and the remainder from traditional official sources. Reflecting larger borrowings in recent years and the deterioration in the maturity structure and the terms of indebtedness in connection with the increasing share of borrowing from private sources, debt service payments as a percentage of exports of goods and services will increase to 13 per cent in 1979 and to about 15 per cent in 1980. The authorities felt that during the plan period (1977-81), it would be possible to limit foreign borrowing to an amount equivalent to one third of planned investment and to keep the debt service burden at about 17 per cent.

The nominal effective trade-weighted exchange rate depreciated by 8 per cent during 1978. This depreciation was facilitated by the adoption in April 1978 of a new basket to determine the exchange rate of the dinar. The authorities indicated that this policy has allowed Tunisia to reverse the effective appreciation which took place during 1973-76 and has improved the competitiveness and the financial situation of export-oriented enterprises, despite unfavorable trends in overall world market prices and rising domestic costs in recent years. For 1979, they intend to maintain the effective exchange rate of the dinar relatively stable and they will adjust their basket, if necessary, to achieve this objective.

Little change has taken place in the trade and payments system since the last consultation. Although the import system remains complex, various measures have been adopted in recent years to simplify administrative procedures. The authorities recognize the potential benefits that an economy can derive from the liberalization of restrictions and they reiterated their objective to further liberalize and simplify the existing import regime.

While the authorities were generally satisfied with the outcome of their economic and financial policies in recent years, they remained concerned about Tunisia's high level of unemployment and the wide disparities in the distribution of income which led to considerable social unrest during 1977 and 1978. Although the present development plan aims at solving these problems by increasing investment and productivity in agriculture and by developing a labor-intensive export sector, the authorities felt that the success of their efforts had been affected by certain factors beyond their control, such as adverse weather conditions and unfavorable external market conditions.

cc: CBS, ETR, FAD, INST, LEG, RES, TRE, Mr. Ware

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INTERNATIONAL MONETARY FUND

TUNISIA

Briefing Paper - 1979 Article IV Consultation

Prepared by the African Department and the Exchange
and Trade Relations Department

(In consultation with the Legal Department
and the Treasurer's Department)

Approved by Jack D. Guenther and S. Kanesa-Thasan

February 16, 1979

A mission consisting of Mr. Ch.A. Francois (head-AFR), Mrs. M. Tyler (ETR), Mr. J. Hill (AFR), Mr. H. Horie (AFR), and Mrs. M.-J. Bauer (secretary-AFR) will visit Tunis during the period February 28-March 13, 1979 to conduct the 1979 Article IV consultation discussions. A summary of the Fund's relations with Tunisia is provided in the attached Appendix.

I. Recent Economic Developments

Following a marked slowdown in 1977 (due mainly to sharply reduced harvests of cereals and olives), the Tunisian economy grew in real terms by almost 9 per cent in 1978, or by about the same annual average rate achieved during the period 1974-76. In addition to a recovery in agricultural production, the improved economic performance reflected a continued expansion in petroleum production, manufacturing, construction, and transportation. Despite a marginal slowdown in the growth of real investment, real aggregate demand rose faster (8.6 per cent) than in 1977 (6.9 per cent). The principal factor in this development was an acceleration in the expansion of private consumption, stemming mainly from the recovery in agricultural output, but also from higher wages and producer prices. The slightly lower rate of expansion in overall investment resulted from a sharp reduction (from 25 per cent in 1977 to less than 9 per cent in 1978) in the growth rate of the combined investment of the government and public enterprises. As a result of these developments, the resource gap as a percentage of GDP in real terms remained essentially unchanged (at about 11 per cent) in 1978.

Despite the expansion in real aggregate demand, the domestic inflation rate in 1978 remained at the same level as in 1977 (about 6 per cent), as a result of the improved supply situation, smaller increases in wages, and continued consumer price subsidies granted through the Price Stabilization Fund. In January 1977, the Government concluded with the labor unions a social contract under which wages are annually adjusted in line with past increases in the cost of living and gains in productivity. Following a 33 per cent increase in the minimum wage in early 1977, the Government further raised the minimum wage by 11 per cent in May 1978 in order to compensate for the increase in the cost of living between January 1977 and February 1978.

Tunisia's Fifth Development Plan (1977-81) envisages annual rates of real growth for exports (10 per cent) and GDP (7.5 per cent), and a more rapid expansion of employment opportunities. In order to achieve these objectives, the Plan calls for an overall nominal investment target of D 4.2 billion, 1/ which corresponds to an average annual level of real

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1/ SDR 1 = D .4034 at the end of December 1978.

investment equivalent to 30 per cent of GDP as compared to 24 per cent during the period 1973-76. However, because of the high level of investment already reached in 1976, the average annual rate of growth in real investment is projected at 4 per cent and would not result in an increase in the ratio of investment to GDP. The planned investment strategy is broadly geared to expanding labor-intensive and export-oriented activities, and envisages that a larger share of total investment be implemented by the public enterprise sector. In order to achieve this target, the Plan calls for larger domestic savings and expanded recourse to foreign borrowing.

The public enterprises, which were expected to contribute significantly to domestic savings and investment under the Plan, have had to contend increasingly with upward pressures on wages and costs in the last few years, while prices in foreign markets have been generally stagnant. Moreover, domestic prices for essential commodities and services, which are officially controlled, have not been adequately adjusted. Therefore, the growing investments of public enterprises have had to be financed increasingly by Treasury resources and foreign borrowing.

In 1978 the increase in Treasury lending to public enterprises to finance their investment programs, together with higher government direct investment outlays, caused the overall budget deficit to widen by an estimated 14 per cent to a level equivalent to 7 per cent of nominal GDP. Revenue and grants are estimated to have grown by 14 per cent, or at about the same rate as the growth in nominal GDP. As most of the increased budgetary resources were absorbed by higher current expenditure, especially for price subsidies, interest on the public debt, and the second tranche of the wage increase under the 1977 social contract, current budget savings increased only marginally (3 per cent). Capital expenditure, including net lending to public enterprises, which grew at an average annual rate of 30 per cent in 1976-77, rose by only 8 per cent in 1978, as the Government delayed the execution of certain major projects. Nearly half of capital outlays and net lending were covered by current budget savings, one fourth by recourse to foreign borrowing (including from international capital markets), and the remainder by domestic borrowing. As net foreign borrowing was somewhat below the level of 1977, the Treasury increased its reliance on domestic bank financing, especially from commercial banks.

The 1979 budget aims to increase the level of current savings and to avoid a further widening of the overall budget deficit. Revenue is forecast to rise by 16 per cent, mainly in response to a further expansion in economic activity and, to a more limited extent, new tax measures and efforts to improve revenue collection. As the growth in current outlays is expected to be limited to 14 per cent, the current budget surplus would rise by almost one fifth. Although net lending to public enterprises will increase by 13 per cent, the growth in direct government investment is expected to be reduced to only 4 per cent so that the overall budget deficit would remain essentially unchanged. As net foreign borrowing is projected to rise moderately, the Treasury is expected to reduce somewhat its reliance on domestic bank borrowing.

In 1978, net domestic credit is estimated to have expanded by 18 per cent (compared with 14 per cent in 1977), with net claims on Government rising more rapidly than credit to the private sector. An increase in the net foreign assets of the banking system, together with the expansion in net domestic credit, caused the stock of money and quasi-money to grow faster (17 per cent) than nominal GDP. During 1978, government recourse to the Central Bank declined and, reflecting the increased liquidity in the economy and the reduction in the minimum reserve requirement, the deposit money banks reduced their reliance on central bank rediscounts.

Despite a further widening in both the trade and current account deficits, Tunisia's overall balance of payments moved from a deficit of SDR 51 million in 1977 to a surplus of SDR 22 million in 1978. Although exports of citrus fruits, wines, and clothing rose considerably, overall export earnings increased by only 5 per cent (18 per cent in 1977) as exports of phosphate rock continued to decline. Import payments rose by only 6 per cent (also 18 per cent in 1977) as higher imports of consumer goods and equipment were partly offset by a decline in imports of raw materials and semifinished goods. The terms of trade, which had declined sharply during the period 1974-76 and rose moderately in 1977, remained virtually unchanged in 1978. The current account deficit widened (by 9 per cent) but remained at a level equivalent to 10 per cent of GDP. As the deficit was more than covered by a higher level of net inflows of capital (SDR 500 million), there was an appreciable increase in the level of gross official reserves. At the end of 1978 such reserves amounted to SDR 346 million, or the equivalent of 2.5 months of 1978 merchandise imports, as compared to a corresponding figure of 2.3 months for 1977.

In 1979 the deficit on the current account of the balance of payments is projected to widen slightly but would decline somewhat in relation to GDP. Export receipts are forecast to grow by 13 per cent, primarily reflecting higher export volume and prices of petroleum. Although import payments are expected to rise by 11 per cent (mainly for equipment goods, raw materials, and semifinished goods), their absolute increase will exceed the rise in exports so that the trade balance will widen further. As the authorities envisage covering the projected current account deficit by increased foreign borrowing, Tunisia's net foreign assets position is likely to remain unchanged.

Tunisia's outstanding external public debt increased by 22 per cent to SDR 1.9 billion in 1978, reflecting mainly increased borrowing from both official sources and capital markets. Debt service payments, which rose by 17 per cent in 1978, are estimated to increase by 25 per cent in 1979. The ratio of such payments to exports of goods and services was 13 per cent in 1978 and is expected to increase to about 14 per cent in 1979.

Following the sharp improvement in 1974 in the terms of trade due to higher export prices, the authorities pursued an effective appreciation of the Tunisian dinar. The nominal effective trade-weighted exchange rate appreciated by 9 per cent between December 1973 and December 1976, remained virtually unchanged in 1977, but depreciated by 8 per cent during 1978. The depreciation in 1978 was partly achieved by a revision of the number and the weights of the currencies included in the basket used to determine the exchange rate determination. The real effective exchange rate (adjusted for differential rates of inflation between Tunisia and its trading partners) appreciated by about 13 per cent between December 1973 and December 1975, reflecting a relatively worse price performance in Tunisia. By the end of September 1978, helped by Tunisia's better price performance during the subsequent period, this rate depreciated to virtually the same level prevailing at the end of 1973.

The exchange and trade system has remained basically unchanged since the last Article XIV consultation. Tunisia continues to avail itself of the transitional arrangements under Article XIV and maintains a relatively complex exchange and trade system. Although little progress was made toward achieving a liberalization of the exchange and trade system, information currently available indicates that the existing regulations are applied liberally for a large part of the country's imports.

II. Topics for Discussion

In recent years, the Tunisian economy has grown at generally high rates, stimulated by rising levels of consumption and investment. However, as a result of the expanding aggregate demand, together with an erosion in the 1974 terms of trade gains, there has been a progressive weakening in both the budgetary situation and in the current account of the balance of payments, which has led to greater recourse to external financial resources. Moreover, continued increases in wages and costs have adversely affected the financial performance of the public enterprises and increased their reliance on Treasury assistance. For 1979, the authorities have adopted financial policies which, together with a relatively high rate of economic growth, would permit a greater share of the rising level of investment to be financed by domestic savings so as to avoid a substantial weakening in the overall financial situation.

1. Against this background, the mission will review recent production developments in the major sectors and discuss the outlook for economic growth in 1979 with specific reference to the output prospects for the principal export products and for agricultural crops. For the medium term, the main sectoral investment targets will be reviewed and their likely impact on employment, production, and exports will be ascertained. The overall strategy of financing investments will be discussed in the context of the Plan's assumptions regarding domestic savings forecasts and envisaged foreign borrowing.

2. The mission will assess the financial situation of the public enterprises, and in particular, the prospects of achieving the current Plan's targets for public enterprises' savings and investment. It will discuss with the authorities the economic efficiency of these enterprises and the extent to which their financial performance is expected to be affected by government policies related to the procedures for wage adjustments, the scope of direct controls and subsidies as means of limiting price increases, and the role of fiscal incentives and budgetary assistance to finance investments.

3. The mission will review recent developments in fiscal performance, with reference to revenue and expenditure trends. The budget estimates for 1979 will be discussed in terms of revenue projections and the main

areas of expenditure growth. The mission will discuss with the authorities expenditure policies and priorities with reference to the main components of recent expenditure growth, namely, wage payments, subsidies and transfers, and investments. The overall financing of government fiscal operations and its implications for monetary policy and the foreign debt situation will be discussed. The budgetary savings target of the current Plan will be reviewed in the context of the revenue measures and expenditure policies that may be contemplated by the Government.

4. In recent years, the banking system has increased credit to the Government at a rapid rate, while limiting the rate of expansion of credit to the private sector to a moderate level. The mission will discuss with the authorities the extent to which the rapid increase in bank credit to the Government has been intended as a matter of overall financial policy, and the institutional channels and instruments of credit control through which this policy has been so far achieved. The authorities' broad projections for credit expansion to the private sector will be examined in terms of sectoral or project priorities, and in terms of the instruments of credit policy to be used for the achievement of those objectives. The mission will also review the recent trends and the 1979 forecasts for the main monetary aggregates, in the context of the authorities' objectives for economic growth, the acceptable rate of price increase, and the balance of payments.

5. The mission will discuss with the authorities the factors underlying the progressive deterioration in the country's current account deficit

of the balance of payments. A special effort will be made to ascertain and assess the impact on Tunisia's export growth of unfavorable conditions in foreign markets, including continued sluggish demand for phosphates and restrictive measures taken by some of Tunisia's major trading partners. The mission will also discuss the detailed official forecast for the 1979 balance of payments in terms of the projections for the main categories of exports and imports, and for other major components of the balance of payments. The authorities' policies with regard to the extent and nature of foreign borrowing in 1979 and in the medium term will be examined and discussed; also, the prospects for the debt service burden will be appraised. The mission will emphasize the need to channel such borrowing into highly productive investment projects and that the overall level of the debt and its servicing burden be kept within manageable limits.

6. The present system of determining exchange rates and its underlying rationale, as well as the appropriateness of the present level of the exchange rate, will be discussed. The mission will update information on the foreign exchange and trade system, and ascertain the progress the authorities have made or intend to make toward liberalizing and simplifying the existing complex system. In this context, the mission will stress the potential benefits that the economy would derive from a more substantial liberalization of the system of restrictions.

Fund Relations with Tunisia

Date of membership:	April 14, 1958
Quota:	SDR 63 million
Exchange system:	Since January 23, 1974, Tunisia has fixed the dinar rate for the French franc in the light of quotations for certain major currencies, mainly the deutsche mark and the U.S. dollar. Recently, a payments-weighted basket approach to exchange rate determination has been gradually adopted. As of December 31, 1978, the dinar rate for the U.S. dollar was D 1 = US$2.48 equivalent to D 1 = SDR 1.90.
Use of Fund resources:	In August 1977 Tunisia purchased SDR 24 million under the compensatory financing facility. As of January 31, 1979, the Fund's holdings of Tunisian dinars amounted to SDR 75.3 million, equivalent to 120 per cent of quota (81.5 per cent of quota excluding the compensatory drawing).
SDR position:	As of January 31, 1979, Tunisia's holdings of SDRs amounted to SDR 15.1 million, equivalent to 71 per cent of its net cumulative allocation of SDR 21.3 million.
Gold distribution:	Tunisia acquired 30,810 troy ounces of fine gold in the first three phases of distribution.

The last Article XIV consultation discussions with Tunisia were held in Tunis during the period February 28-March 14, 1978. The staff report (SM/78/127) and recent economic developments paper (SM/78/182) were discussed by the Executive Board on August 4, 1978.

Office Memorandum

cc: Mr Kanesa-Thasan

TO : Acting Managing Director

DATE: March 22, 1978

FROM : Ch. A. François

SUBJECT : Tunisia--Article XIV Consultation Discussions

A mission consisting of Messrs. A. Basu (AFR), H. Horie (AFR), E. Maciejewski (YP-ETR), Ms. R. Bedrossian (secretary-TRE), and myself visited Tunis during the period February 28 to March 14, 1978 to conduct the 1978 Article XIV consultation discussions and a special consultation related to the forthcoming world economic outlook exercise. The mission was most cordially received and the discussions were frank and comprehensive. Meetings were held with Mr. Mohamed Ghenima, the Governor of the Central Bank, and with Mr. Abdelaziz Mathari, the new Minister of Finance, as well as with other ministers and senior officials dealing with economic and financial matters. These discussions took place a few weeks after a major Government reshuffle on December 26, 1977 and a general strike organized by trade unions on January 26, 1978, which led to violence and riots, mainly in Tunis.

Tunisia's overall economic and financial performance during 1970-76 was strong, as real GDP grew at an annual rate of 9 per cent, stimulated by substantial increases in private and public investment. Weather conditions were generally favorable for expanding agricultural output, the latter induced growth in agro-processing industries, and world market prices for Tunisia's major exports (petroleum, phosphate, and olive oil) rose sharply during 1974-75. Although consumption expanded more rapidly than in the past, the share of domestic savings in total capital formation increased and reached more than four-fifths.

In 1977, the annual growth rate of real GDP slowed down to 4 per cent. As agricultural production of cereals and olives declined sharply, the economic growth stemmed almost entirely from the continued expansion of nonagricultural activities, primarily in the petroleum and manufacturing sectors. On the demand side, investment, especially in the public sector, continued to rise, and private consumption was stimulated, as wage rates were raised substantially in early 1977. Owing to substantial subsidies on essential foodstuffs (e.g., wheat flour, edible oil, and meat), and petroleum products, domestic prices increased only moderately (by about 6.6 per cent). As these developments were accompanied by a deterioration in the external terms of trade, the resource gap increased to 11 per cent of GDP and recourse to foreign borrowing increased noticeably.

Reflecting measures to increase tax rates and reduce tax evasion, government receipts rose by 19 per cent in 1977. Although current expenditures (including price subsidies) increased at a faster rate than receipts, the current surplus remained sizable. However, with higher capital expenditures, and net transfers and lending to state enterprises for investment, the overall fiscal deficit nearly doubled to D 150 million, or equal to 7 per cent of GDP. About half of this deficit was financed by domestic resources, mainly public sector deposits with the Treasury. The remainder was financed from abroad and included for the first time a recourse to the international financial market (US$125 million). The public enterprises have continued to experience upward pressures in wages and other costs, while prices on both domestic and foreign markets have been stagnant. As a result they have relied increasingly on budgetary resources, foreign borrowing, and the domestic banking system. Domestic credit rose by about 15 per cent, mainly because the Central Bank increased its rediscounts and reduced the ratio of reserve requirements, and commercial banks increased their holdings of Government equipment bonds.

The current account deficit of Tunisia's balance of payments widened by 55 per cent to SDR 489 million in 1977, reflecting mainly a substantial deterioration in the trade balance and a reduced net services surplus. Despite generally unfavorable conditions in external markets, export earnings increased by 16 per cent, mainly because of higher volume of petroleum, phosphates, and textile exports. At the same time, imports increased by 18 per cent, largely due to a sharp increase in imports of raw materials and of consumer goods (including cereals). Despite increased external borrowing, the balance of payments showed an overall deficit of SDR 51 million. At the end of 1977, gross official foreign reserves amounted to SDR 294 million, or the equivalent of 2 months of 1977 merchandise imports, as compared with a corresponding figure of 2.9 months for 1976.

The 1977-81 Development Plan calls for an average annual rate of growth of 7.6 per cent in real GDP and of about 4 per cent in real gross fixed capital formation. In particular, economic prospects for 1978 are broadly favorable. The growth of real GDP is likely to be close to 10 per cent, with a recovery in agricultural production. The export volumes of petroleum and of phosphate derivates are expected to continue expanding, while exports of manufactures are likely to show little increase. In addition to expanding investments, consumption will also increase appreciably, as a new upward adjustment in wages is expected in April. With the terms of trade showing little change over 1977, these trends in production, investment and consumption are likely to lead to a wider resource gap.

In 1978 the overall fiscal deficit is forecast to increase by about one third (to D 200 million). With no major new revenue measures, government receipts are expected to grow roughly in line with GDP (or 16 per cent). At the same time, primarily reflecting public wage increases and higher price subsidies, current expenditures are to increase by more than one-fifth, leading to a somewhat reduced current surplus. As part of the investment effort, capital expenditures and net lending are to be expanded by about 15 per cent. Almost three-fifths of the larger overall deficit is to be financed by foreign borrowing (including about US$140 million from the international capital markets), and a major part of the domestic financing is to be obtained from the banking system. Recourse to the banking system is expected to take the form of a drawdown of government deposits at the Central Bank, and mainly, sales of equipment bonds to the deposit money banks. Based on a forecast of the growth of broad money equal to that of GDP, and on an objective of achieving an equilibrium in the balance of payments, the authorities are planning to limit the expansion of overall domestic credit to about 19 per cent.

In 1978, the current account deficit of the balance of payments is forecast to increase by 17 per cent, and the net capital inflows needed to finance it would have to be almost 32 per cent higher. Exports are projected to grow at a slower rate (12 per cent) than the previous year, mainly due to continued sluggishness in external demand conditions, including in particular, the EEC restrictions on textile imports. The growth of imports is forecast to be somewhat slower than that of exports, and would primarily be in the form of essential raw materials and equipment goods. However, the trade deficit is expected to widen, and in addition, mainly due to growing service payments associated with investment projects, and no major gains in tourism receipts, the net surplus on services is expected to decline. With the envisaged increase in foreign borrowing, the ratio of outstanding official foreign debt to GDP is expected to rise from 37 per cent in 1977 to 42 per cent in 1978. However, the ratio of debt service payments to exports of goods and nonfactor services would remain moderate (about 14 per cent). The authorities assured the mission that most of the foreign borrowing would be used for productive investments, with assured net return in terms of foreign exchange.

Since January 1974, Tunisia has followed an independent exchange rate policy under which the dinar relationship to the French franc is fixed in the light of quotations for certain major currencies, mainly the deutsche mark and the U.S. dollar. This policy has allowed Tunisia to maintain relative stability of the dinar in terms of SDR and the import-weighted effective exchange rate since end-1976. However, as a large part of Tunisia's export receipts are denominated in U.S. dollars, the exchange rate policy has resulted in an appreciation of the effective export-weighted exchange rate. The authorities indicated that in the future they will limit the appreciation of the dinar vis-à-vis the dollar to avoid pressures on the financial situation of export enterprises. In the context of the new provision on surveillance of exchange rates (under Article IV), they also agreed to provide us with a clear description of the existing system of exchange rate determination.

Little change has taken place in the trade and payment system since the last consultation. The basic legal texts codifying and simplifying existing legislation were promulgated in January 1976 and July 1977, but detailed implementing regulations have not yet been issued. However, various measures have been adopted in recent years to simplify existing administrative procedures and practices. The authorities indicated that it is their intention to introduce the new implementing regulations in the coming months, and to gradually shift from quantitative import restrictions to protection through customs tariffs.

cc: Managing Director (upon return)

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INTERNATIONAL MONETARY FUND

TUNISIA

Briefing Paper - 1978 Article XIV Consultation Discussions

Prepared by the African Department and the Exchange and Trade Relations Department

(In consultation with the Legal Department and the Treasurer's Department)

Approved by J.B. Zulu and S. Kanesa-Thasan

February 23, 1978

A mission consisting of Messrs. Ch. A. François (head-AFR), A. Basu (AFR), H. Horie (AFR), E. Maciejewski (YP-ETR), and Ms. R. Bedrossian (secretary-TRE) will visit Tunis during the period February 28 to March 14, 1978 to conduct the 1978 Article XIV consultation discussions, and a special consultation for the forthcoming World Economic Outlook exercise. A summary of the Fund's relations with Tunisia is provided in the attached Appendix.

I. Recent Economic Developments

The Tunisian economy experienced a slowdown in 1977. The annual growth rate of real gross domestic product (GDP) dropped from an average of 7 per cent during 1973-76 to 4 per cent in 1977, mainly due to sharply reduced harvests of cereals and olives, and a decline in tourism. However, the production and exports of petroleum, phosphates, and manufactured textiles recorded noticeable increases. There was also continued expansion of economic activity and employment in other manufacturing, construction, and transport, stimulated by private and public investments which rose steadily from 20 per cent of nominal GDP in 1973 to 32 per cent in 1977. In the past three years, there has been a moderate growth of real per capita private consumption, as wage rates were adjusted upward in 1975 and 1977, and price subsidies for foodstuffs helped to limit the annual rate of increase in prices (6 per cent during 1976-77). At the same time, reflecting an overall deterioration in the external terms of trade and the expansion of public investment, the fiscal deficit has widened, the resource gap has doubled (to 10 per cent of GDP), and recourse to foreign borrowing has increased noticeably.

In 1978, the output and export volume of petroleum are projected to continue to rise. In addition, the prospects for increased production of phosphate derivates and olives are favorable, and with improved weather conditions, the output of cereals should recover. Compared to trends during the last Plan period (1973-76), the Fifth Plan covering the years 1977-81 envisages somewhat higher annual rates of real growth for exports (10 per cent) and GDP (7.5 per cent), and a more rapid expansion of employment opportunities. There is no major shift in sectoral investment strategy under the current Plan, which continues to provide sizable allocations (ranging between 12-23 per cent) for manufacturing, energy, housing, transport, and agriculture, and is broadly geared to expanding labor-intensive and export-oriented activities. In order to achieve a targeted annual rate of investment expansion (of 4 per cent in real terms), the current Plan calls for a larger domestic savings effort, an expanded recourse to foreign borrowing, and a somewhat improved rate of project implementation.

The public enterprises, which are expected to contribute significantly to domestic savings and investment under the new Plan, have had to contend increasingly with upward pressures on wages and costs in the last three years, while prices in both domestic and foreign markets have been either stagnant or declining. Export prices have tended to decline and with few exceptions (cement and fuel), the domestic prices for essential commodities and services, which are officially controlled, have not been adjusted. In 1977, with a view to holding wage increases in line with trends in productivity, the Government entered into an agreement with workers' unions to develop a procedure for future adjustments in wages.

During 1975-77, both government revenues and current expenditures (including price subsidy operations) increased roughly in line with nominal GDP (15 per cent). In each year there was a sizable current surplus, which on average was equivalent to about 7 per cent of GDP. However, with the emphasis on expanding public investment, capital expenditures plus net lending (to public enterprises) have exceeded the current surplus by a large margin, and the overall fiscal deficit more than tripled to about D 141 million (or equal to one fifth of total outlays). In 1977 about half this fiscal deficit is estimated to have been financed by domestic resources, of which a large part (D 31 million) was obtained from the banking system (primarily from commercial banks). The Government's net foreign borrowing increased noticeably and included for the first time a recourse to the international financial markets (of D 44 million).

Official budget estimates for 1978 forecast receipts to increase by 14 per cent and total outlays to be up by 16 per cent, which would lead to a larger fiscal deficit (D 171 million). The budget includes no major adjustments in tax rates, and of the envisaged expansion in total outlays roughly two thirds would be of a current nature (mainly for wage payments and price subsidies), and the remainder represents capital expenditures plus net lending. In contrast to previous years, more than half the fiscal deficit is to be financed by foreign resources, with a sizable amount to be mobilized from the international capital markets (D 60 million). The remainder of the deficit would be covered by increased domestic borrowing, primarily from commercial banks.

Over the last two years, net domestic credit has expanded at an average annual rate of 19 per cent, with net claims on government rising much more rapidly than credit to the private sector. The Government's net indebtedness to the Central Bank, which increased about fivefold in 1976 and by a further 20 per cent in the first 11 months of 1977, was due almost entirely to the drawdown of government deposits. During 1977, while the Government's net recourse to the Central Bank slowed down, the deposit money banks' reliance on central bank rediscounts increased sharply (by 45 per cent). Over the past two years, the deposit money banks expanded their claims on the private sector at a moderate pace (16 per cent annually) and credit to the Government at rates more than twice as fast. As the stock of money plus quasi-money grew roughly in line with nominal GDP, the more rapid expansion of domestic credit contributed to sizable reductions in net foreign assets.

Tunisia's overall balance of payments showed a substantially enlarged deficit of SDR 49 million in 1977, compared with deficits which averaged

SDR 11 million during 1975-76. Over these years, the gap in the current account tripled to SDR 461 million, primarily due to a growing trade deficit. Since 1974 the terms of trade have deteriorated by roughly 17 per cent, and in real terms, the average annual rate of growth for imports (10 per cent) has exceeded that of exports (6 per cent). In addition to an increasing volume of imports of equipment and raw materials for industry, in 1977 the quantity of consumer goods imports also rose, mainly due to the poor cereal harvest. The overall growth of export volume was achieved despite generally unfavorable conditions in external markets. Slackness in world demand has adversely affected exports of phosphates since 1975. In the EEC markets, Tunisia's exports of olive oil have been discouraged by a protective levy, and those of certain textile products are reported to have recently become subject to restrictions. Payments for freight and insurance, and for interest on the foreign debt have been increasing, and since 1976, receipts from tourism and workers' remittances have stagnated. Although the widening deficits in the current account have been largely covered by a rapidly growing amount of net capital inflows, the level of gross official foreign reserves has been declining. At the end of 1977 such reserves amounted to SDR 294 million, or the equivalent of 2.4 months of 1977 merchandise imports (c.i.f.), as compared with a corresponding figure of 2.9 months for 1976.

In 1978 the deficit on the current account of the balance of payments is projected to widen to SDR 541 million (equal to about 11 per cent of GDP). Export receipts are forecast to grow by 12 per cent, primarily reflecting higher volumes of petroleum and phosphate exports. However, import payments are projected to grow at a somewhat faster rate largely in the form of increased imports of equipment and raw materials. As the authorities envisage covering the projected current account gap by increased net foreign borrowing (including recourse to the international capital market), Tunisia's net foreign assets position is likely to remain unchanged.

Tunisia's outstanding external public debt increased by US$283 million in 1976 and by US$401 million in 1977, reflecting increased foreign borrowing from both international organizations and capital markets. Debt service payments, which rose by 20 per cent in 1977, are estimated to increase at the same rate in 1978. The ratio of such payments to exports of goods and nonfactor services was 12.8 per cent in 1977 and is expected to increase to about 14 per cent in 1978.

The import- and export-weighted effective exchange rate of the dinar, after adjusting for relative changes in domestic and foreign wholesale prices, appreciated by about 6-7 per cent between end-1973 and end-1976, and in 1977 showed virtually no change. The exchange and trade system has remained basically unchanged since the last Article XIV consultation. The implementing legislation for the new 1976 code simplifying the complex existing administrative procedures of compliance with foreign exchange and trade regulations has not been officially issued.

II. Topics for Discussion

In the past five years, Tunisia's rate of economic growth has been generally high, except when exogenous factors such as poor weather conditions have caused agricultural output to decline and/or unfavorable developments in foreign markets have adversely affected the major exports. However, since 1975 the country's financial situation has weakened, mainly because government current expenditures and the overall level of investment have risen rapidly, while trends in the terms of trade have been unfavorable. There are also indications that since 1975, continued increases in wages and costs have adversely affected the financial performance of the public enterprises. Moreover, in recent months there were civil disturbances in Tunis, when the Government attempted to resist trade unions' demands for further wage increases. With a domestic environment of increasing social discontent and continued sluggishness in external demand conditions, the main problem facing the Tunisian authorities is to adjust economic and financial policies in ways that would be conducive to high rates of economic growth and export expansion, and that would permit a rising level of investment to be financed from domestic savings, without substantially weakening the balance of payments and the still manageable external debt situation.

1. Against this background, the mission will review recent production developments in the major sectors, and discuss the prospects for economic growth. For 1978 the outlook for economic growth will be assessed with specific reference to the output prospects for the principal export products and for agricultural crops. For the medium term, the main sectoral investment targets will be reviewed and their likely impact on employment, production, and exports will be ascertained. The overall strategy of financing investments will be discussed in the context of the

Plan's assumptions regarding domestic savings forecasts and envisaged foreign borrowing.

2. The mission will assess the financial situation of the public enterprises, and in particular, the prospects of achieving the current Plan's targets for public enterprises' savings and investment. It will discuss with the authorities the extent to which the financial performance of public enterprises is expected to be affected by government policies related to the procedures for wage adjustments, the scope of direct controls and subsidies as means of limiting price increases, and the role of fiscal incentives and budgetary assistance to finance investments.

3. The mission will review recent developments in fiscal performance, with reference to revenue and expenditure trends. The budget estimates for 1978 will be discussed in terms of revenue projections and the main areas of expenditure growth. The mission will discuss the authorities' expenditure policies and priorities with reference to the main components of recent expenditure growth, namely, wage payments, subsidies and transfers, and investments. The overall financing of government fiscal operations and its implications for monetary policy and the foreign debt situation will be discussed. The budgetary savings target of the current Plan will be reviewed in the context of the revenue measures and expenditure policies that may be contemplated by the Government.

4. In recent years, the banking system has increased credit to the Government at a rapid rate, while limiting the rate of expansion of

credit to the private sector to a moderate level. The mission will discuss with the authorities the extent to which this development has been intended as a matter of overall financial policy, and the institutional channels and instruments of credit control through which this policy has been so far promoted. The authorities' broad projections for credit expansion to the private sector will be examined in terms of sectoral or project priorities, and in terms of the instruments of credit policy to be used for the achievement of those objectives. The mission will also review the recent trends and the 1978 forecasts for the main monetary aggregates, in the context of the authorities' objectives for economic growth, the acceptable rate of price increase, and the balance of payments.

5. The mission will discuss with the authorities the factors underlying the recent deterioration in the country's balance of payments situation. A special effort will be made to ascertain and assess the impact of unfavorable conditions in foreign markets, which have hampered Tunisia's export growth. More specifically, the mission will try to find out the nature of the difficulties that Tunisia is reported to be facing on the export side, as a result of restrictive measures taken by its major trading partners. The mission will also discuss the detailed official forecast for the 1978 balance of payments, in terms of the projections for the main categories of exports and imports, and for other major components of the balance of payments. The authorities' policies with regard to the extent and nature of foreign borrowing in

1978 and in the medium term will be examined and discussed; also, the prospects for the debt service burden will be appraised.

6. The present system of determining exchange rates and its underlying rationale, as well as the appropriateness of the present level of the exchange rate, will be discussed. The mission will update information on the foreign exchange and trade system, and ascertain the progress the authorities have made or intend to make toward liberalizing and simplifying the existing complex system. In this context, the mission will stress the potential benefits that the economy would derive from a substantial liberalization of the system of restrictions.

Fund Relations with Tunisia

Date of membership: April 14, 1958

Present quota: SDR 48 million

Sixth General Review of Quotas and Second Amendment to the Articles of Agreement: Proposed quota is SDR 63 million. Tunisia accepted the Second Amendment to the Articles of Agreement and consented to the proposed new quota increase in December 1977.

Exchange system: Since January 23, 1974, Tunisia has fixed the dinar rate for the French franc by taking into consideration the premium of the deutsche mark in relation to the French franc from their previous central rate-parity relationship; the resulting appreciation vis-à-vis the French franc is then reduced by an adjustment factor (in principle, two percentage points). As of January 31, 1977, the dinar rate for the U.S. dollar was D 1 = US$2.4266, equivalent to D 1 = SDR 1.9976.

Use of Fund resources: In August 1977, Tunisia purchased SDR 24 million under the Compensatory Financing facility. As of January 31, 1978, the Fund's holdings of Tunisian dinars amounted to SDR 60 million, equivalent to 125 per cent of quota (75 per cent of quota excluding the compensatory drawing).

SDR position:	As of January 31, 1978, Tunisia's holdings of SDRs amounted to SDR 9.6 million, equivalent to 65 per cent of its net cumulative allocation of SDR 14.7 million.
Gold distribution:	Tunisia acquired 20,540 troy ounces of fine gold equivalent to SDR 0.72 million in two phases of distribution.
Staff contacts:	The last Article XIV consultation discussions with Tunisia were held in Tunis during the period February 21-March 4, 1977. The staff report (SM/77/102 and Supplement 1) and recent economic developments paper (SM/77/118) were discussed by the Executive Board on August 12, 1977.

1977

Office Memorandum

cc: Mr. Sweeney
Mrs. Tyler

RECEIVED
MAR 10 1977

TO : Managing Director
Deputy Managing Director

DATE: March 9, 1977

FROM : E.L. Bornemann

SUBJECT : Tunisia - 1977 Article XIV Consultation Discussions

A mission consisting of M. Tyler (ETR), A. Basu (AFR), H. Horie (AFR), C. Buggs (secretary-AFR), and myself visited Tunisia during the period February 21-March 4, 1977 to conduct the 1977 Article XIV consultation discussions. As usual, the discussions were most efficiently organized by the authorities, and the policy discussions were cordial and comprehensive. The mission had meetings with the Minister of Finance, the Secretary of State for Planning, the Minister of National Economy, the Governor of the Central Bank, and other senior government officials. Mr. Amuzegar, Executive Director, attended some of the policy discussions.

The mission arrived at a time when the authorities were reviewing the results of the just completed Four-Year Development Plan (1973-76), and were in the final stages of preparing the new Five-Year Plan for the period 1977-81. On the whole, the achievements under the Four-Year Plan have been impressive. Among the more notable results have been the attainment of a high rate of economic growth (annually 7.4 per cent in real terms), a substantial increase in employment (even exceeding the targets of the Plan), and a high share of productive investments in total investment outlays. This favorable result was achieved under conditions of monetary and financial stability and broad balance of payments equilibrium. The share of domestic financing in total investment reached 86 per cent, or much higher than initially envisaged. The economic performance was particularly good in 1976, when the increase in real GDP accelerated to nearly 10 per cent. In part, the favorable outcome during the plan period was the result of unexpected gains in Tunisia's terms of trade in the first half of the plan period resulting from higher export prices for petroleum, phosphates, and olive oil; however, a large part of these gains was eroded in 1975-76. More importantly, the good performance reflected appropriate economic and financial policies of the Government, which succeeded in restraining the growth of consumption, expanding and encouraging public and private investment, and in attracting foreign private investment into Tunisia's growing industrial sector.

According to preliminary indications, the investment target in the 1977-81 Plan will rise to D 4.2 billion, which in real terms is equivalent to an increase in average annual investment of nearly 60 per cent over the previous plan. In setting this ambitious target, the authorities' major aim is to provide employment for the full increase in the labor force during the plan period. In spite of the progress made during the previous plan, unemployment remains a problem, and has recently been aggravated by the virtual halt in net emigration to Western Europe.

Although financing from domestic resources is to decline to 72 per cent of total investment, the ratio of domestic savings to nominal GDP is expected to rise. The Government expects to substantially expand its reliance on external resources, including for the first time in many years borrowing on the international financial markets.

In view of the improvement in absorptive capacity that has taken place in recent years, it seems likely that Tunisia will have the capacity in physical terms to implement the ambitious Five-Year Development Plan. Owing to Tunisia's political stability, its excellent credit rating, and its good relations with the Arab oil-producing countries (from whom important contributions are expected), it should be possible to mobilize the external resources envisaged in the Plan without much difficulty. On the other hand, the mission took the position that the domestic savings target, in particular that of the Government, was quite ambitious, and while not impossible to attain, would require courageous measures. An encouraging start in this direction was made with the 1977 budget, which provided for a substantial increase in tax revenues, both as a result of increased tax rates and various imaginative measures to reduce tax evasion. At the same time, a substantial overall wage increase (averaging 16.5 per cent for the economy as a whole) was granted in both the public and the private sectors. Also, a five-year social contract was concluded with the labor unions for the duration of the new Plan to rationalize the process of wage determination and to keep future wage increases within tolerable limits. Although the Government is making every effort to reduce the impact of the wage increases on prices, considering also the overdue upward adjustment in the domestic price of energy and the tax measures taken in early 1977, it seems likely that consumer prices will increase by some 10 per cent in 1977, or nearly double the rate of 1976.

After achieving successive surpluses in the overall balance of payments since 1968, Tunisia's balance of payments showed small deficits in both 1975 and 1976. This essentially reflected a substantial deterioration in the trade balance, as exports declined in both years from the high level reached in 1974. While export receipts from petroleum stagnated, earnings from phosphates fell sharply owing to lower world market prices, and those from olive oil declined as the EEC effectively restricted Tunisia's access to its main traditional market (Italy). The mission stated that Tunisia appeared to qualify for a purchase under the Compensatory Financing Decision, but the authorities did not express an interest. Imports continued to expand sharply in recent years, largely reflecting Tunisia's development effort. Receipts from tourism and workers' remittances expanded moderately. As a result, the current account deficit almost doubled to SDR 267 million in 1976. The deficit was largely financed by increased net capital inflows, about equally divided between official and private loans. In 1977 the trade deficit is expected to widen further, but the overall balance of payments is expected to remain in equilibrium owing to increased external borrowing. In view of the substantial improvement that has taken place in Tunisia's external debt position since the 1960s, the mission took the view that there is a substantial margin for additional foreign borrowing.

Tunisia has continued its existing exchange rate policy which consists of fixing the rate of the dinar by taking into consideration the movements of the French franc and the deutsche mark. This policy has resulted in an appreciation of the effective import-weighted exchange rate of some 4 per cent in 1976.

With Tunisia's export prices generally determined in world markets, the authorities believe that on the whole this policy has not adversely affected the competitiveness of the export sector. On the other hand, it has had a favorable impact on the domestic price level. The authorities appeared on the whole satisfied with their exchange rate policy.

In the trade and payments field, a new code promulgated in January 1976 consolidated Tunisia's foreign exchange and trade system. However, the code has not been implemented so far, and Tunisia's complex exchange and trade controls continue in force. Although measures have been adopted recently to reduce somewhat restrictions on imports, those on current invisibles have not been eased. When the mission pressed these points, the Tunisian authorities replied that the implementation of the code, which has been delayed due to other pressing matters, was expected shortly. It would streamline regulations, simplify administrative procedures, and incorporate the import liberalization measures referred to above. However, while in principle the authorities expressed their preference toward shifting from quantitative import restrictions to protection through customs tariffs, no substantial move in that direction appears likely in the near future.

The Tunisian authorities are in the process of making the necessary legislative arrangements to accept the amendments of the Articles of Agreement and the quota increase. However, as they intend to take this opportunity to modify the existing internal relations between the Minister of Finance and the Central Bank relating to Fund membership, the effective acceptance of the amendments is likely to be somewhat delayed.

cc: CBS
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Judy Mr. Sweeney

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

TUNISIA

Briefing Paper - 1977 Article XIV Consultation

Prepared by the African Department and the Exchange and Trade Relations Department

(In consultation with the Legal Department and the Treasurer's Department)

Approved by J.B. Zulu and Timothy Sweeney

February 10, 1977

A mission consisting of Mr. E.L. Bornemann (head), Mrs. M. Tyler (ETR), Messrs. A. Basu (AFR), and H. Horie (AFR), and Ms. C.A. Buggs (secretary-AFR), will visit Tunis during the period February 21 to March 4, 1977 to conduct the 1977 Article XIV consultation discussions.

I. Relations with the Fund

Tunisia's current Fund quota is SDR 48 million (proposed: SDR 63 million). An initial par value for the Tunisian dinar equivalent to D 0.525 = US$1.00 was agreed with the Fund on September 28, 1964 and has since remained unchanged. Until January 23, 1974, the rate of the dinar in relation to the French franc had remained fixed. Since then, the dinar buying rate of the French franc is fixed by taking into consideration the discount of the French franc vis-à-vis the deutsche mark in x
Paris from their previous parity relationship; the resulting appreciation of the dinar is reduced by an adjustment factor (in principle, two percentage points). Rates for other currencies are determined on the basis of the cross rates prevailing in the major foreign exchange markets. On December 31, 1976, the rate for the U.S. dollar was D 0.4309, and the corresponding rate for the SDR was D 0.5006.

Tunisia has been granted six consecutive stand-by arrangements by the Fund, the last of which expired in December 1970. Purchases under these arrangements totaled the equivalent of SDR 51.3 million. Since the expiration of these stand-by arrangements, Tunisia has reduced the Fund's holdings of Tunisian dinars to the present level of 75 per cent of quota.

Tunisia has received SDR allocations totaling SDR 14.7 million, and has used SDR 10.7 million, mainly reflecting designation transactions and repurchases from the General Account. Since October 1971 Tunisia acquired a total of SDR 6 million by way of designation, and is included in the current designation plan for a further SDR 1 million. At the end of December 1976, Tunisia's holdings of SDRs were equivalent to SDR 10 million, or 67.8 per cent of its net cumulative allocation. Tunisia has received gold from the Fund, by way of restitution, equivalent to about SDR 0.4 million.

The last Article XIV consultation discussions with Tunisia were held in Tunis in February 1975. The Staff Report (SM/75/81) was considered by the Executive Board on July 2, 1975.

II. Recent Economic Developments

The Tunisian economy has grown at a rapid pace in recent years. During 1976 real gross domestic product (GDP) is estimated to have increased by 9.9 per cent, reflecting a very favorable agricultural harvest (particularly of olives), and relatively high rates of growth in manufacturing, construction and transport. At the same time, owing largely to problems of production by secondary recovery techniques, the output of petroleum decreased, while due to unfavorable external factors mineral production declined and tourism slowed down considerably. The strong overall growth performance of the economy in recent years reflects an upward trend in the ratio of investment to GDP, which after averaging about one fifth during 1969-72 increased to about 30 per cent in 1976. The increased investment effort and a general deterioration in the terms of trade during 1975-76 have contributed to larger but moderate resource gaps and to some deterioration in the fiscal situation.

In 1977 real economic growth is expected to slow down to about 6 per cent, mainly because of an expected stagnation in the production of olives and olive oil, which in turn reflects the end of a normal three-year production cycle for olives. The main sectors contributing to growth would be mining and energy. The output of phosphate rock is forecast to increase from 3.4 million tons to 3.9 million tons, and that of crude petroleum from 3.9 million tons to 4.2 million tons. Owing largely to past investments, manufacturing is also likely to continue to expand despite the expected slump in agricultural processing activities. While the overall level of investment is to expand at a reduced rate (15.5 per cent), the ratio of investment to nominal GDP is expected to increase to 32.0 per cent. Although the ratio of consumption to nominal GDP is forecast to remain virtually unchanged, with the increased investments the resource gap would widen somewhat, and the overall Treasury situation would possibly continue to weaken.

After moderate increases in 1973-74, the rise in the consumer price index accelerated to 9.5 per cent in 1975, reflecting rising prices of imported goods as well as the measure taken in June 1975 to free a large number of goods from existing price controls. In the first 10 months of 1976, the rate of increase in consumer prices slowed down, largely due to lower import prices for cereals and sugar. Effective February 1, 1977, minimum wages for both agricultural and nonagricultural workers have been raised by about one third to compensate for past increases in the cost of living. At the same time, government salaries were also increased.

Tunisia's Fourth Development Plan (1973-76) envisaged a doubling of investments over the previous Plan to D 1.2 billion, with a view to achieving an average annual growth rate of 6.6 per cent. While the latter target was exceeded, the rate of realization of investment in real terms was only 91 per cent because of delays in the execution of public projects as well as unforeseen increases in costs of imported equipment. Despite a remarkable increase in external borrowing in 1976, about 87 per cent of the total investment was financed from domestic resources, as compared with an initial plan estimate of about 76 per cent. This was due to a substantial expansion in public savings, stemming mainly from higher petroleum and phosphate prices. Under the Fifth Development Plan (1977-81), the investment target has been set at D 4.2 billion, with the primary objectives of generating an average annual growth rate of 7.5 per cent and of creating 233,000 new jobs in the nonagricultural sectors. The Fifth Plan allocates a somewhat larger share (66 per cent) of investments to the productive sectors, with particularly increased emphasis to manufacturing. Although financing from domestic resources is to decline to 72 per cent of total investments, the ratio of domestic savings to nominal GDP is expected to rise. In addition, the Government expects to substantially expand its reliance on external resources.

The overall Treasury situation deteriorated in 1976, following a stagnation in current revenue (due mainly to lower petroleum and phosphate exports), and a large increase in capital expenditure. The current surplus was virtually unchanged at D 109 million, equivalent to about 24 per cent of consolidated current receipts. As capital expenditure and net lending to public enterprises increased sharply, the Treasury deficit rose by 76 per cent to around D 126 million. The share of internal financing of this deficit was high (85 per cent), with approximately half being financed by the domestic banking system (including about one fourth by drawing down deposits with the Central Bank). In 1977 central government current receipts are budgeted to rise by about 15 per cent (with some upward adjustments in tax rates), and current expenditure by almost 13 per cent, resulting in a 21 per cent increase in the current surplus. With capital expenditures and net lending estimated to rise by 16 per cent, the overall Treasury deficit would widen further to about D 139 million. One third of the deficit is expected to be financed by external borrowing, about 23 per cent would be financed by the banking system, and the remainder largely by sales of government equipment bonds to the private nonbanking sector.

The increase in broad money supply, which averaged around 25 per cent during 1974-75, slowed down appreciably to about 16 per cent in 1976. Credit to the private sector increased only moderately, while net credit to the Government nearly doubled. In 1977 the Government expects about the same rate of monetary expansion as in 1976, based on forecasts of an overall balance of payments equilibrium and continued increases in net credit to the Government (26 per cent) and the private sector (16 per cent).

Tunisia's balance of payments, which had been in surplus since 1968, recorded deficits of SDR 14 million in 1975 and SDR 10 million in 1976. During the last year, the trade deficit widened, accompanied by a continued deterioration in the terms of trade. Prices for the country's exports (mainly phosphates and olive oil) declined by about 8 per cent, and import prices rose by about 3 per cent. Export receipts virtually stagnated, reflecting sluggish world demand conditions for petroleum, phosphates, and olive oil. Total import payments grew moderately by 7 per cent, as increased imports of equipment and intermediate goods was partly offset by a substantial decline in imports of foodstuffs due to lower import prices. With a slight deterioration in net services and transfers, the current account deficit rose by 65 per cent to SDR 236 million, or the equivalent of 6 per cent of GDP. This deficit was largely financed by increased net capital inflows (mainly private medium- and long-term borrowing). At the end of 1976, gross official reserves amounted to SDR 319 million, equivalent to about three months of projected 1977 imports.

According to official Tunisian forecasts, the balance of payments in 1977 would be in equilibrium. The trade deficit is projected to widen further to SDR 522 million. Exports are expected to grow by about 8 per cent, taking into account higher petroleum prices and a moderate recovery in world demand for phosphates. Imports are forecast to rise by 12 per cent, largely as a result of the continued expansion in investment and manufacturing. Net receipts from services and private transfers are likely to stagnate since higher tourism receipts will probably be offset by a sharp rise in interest payments on the foreign debt, and net receipts from workers' remittances are expected to remain essentially unchanged.

As a result, the current account deficit is projected to grow by 46 per cent to a level of SDR 345 million, or 8 per cent of the projected 1977 GDP. To finance this deficit without any loss of reserves, the Tunisian authorities expect to rely on official loans from OECD and OPEC countries, and for the first time on borrowing from the international financial markets. On the basis of the envisaged borrowing, the outstanding external debt of Tunisia would rise by 24 per cent to SDR 1,457 million (about 35 per cent of the projected 1977 GDP), while the debt service ratio is expected to rise to about 11 per cent (as compared with 9.5 per cent in 1976).

Between the end of 1975 and the end of 1976, the effective import-weighted exchange rate appreciated by about 4 per cent. In the trade and payments field, a new Code consolidating Tunisia's foreign exchange and trade system was established in January 1976. However, the Code has apparently not been implemented, and hence Tunisia's complex import controls continue in force, and restrictions on current invisibles and imports have not been eased. Reflecting the authorities' aim of encouraging the inflow of foreign capital, foreign banks and financial institutions have been authorized to operate in Tunisia and have been given certain privileges, including tax concessions. At the same time, facilities were provided for the gradual transfer abroad of all balances held in nonresident capital accounts.

III. Topics for Discussion

Over the past four years Tunisia has achieved a high rate of growth, while generally maintaining satisfactory domestic and external financial conditions. The economic growth and employment targets of the Fourth Plan have been exceeded. The Government has succeeded in expanding investments, and although overall Treasury deficits have been recorded, these have been financed primarily from nonbank domestic resources. The external trade and current account deficits have grown over the last two years due both to the investment effort and generally unfavorable trends in the world economy, but on the whole the magnitude of such deficits has been in line with the considerable margin that existed for mobilizing external resources. The Fifth Plan (1977-81) envisages a large increase in investment, and a moderate acceleration of economic growth.

Against this background, the mission will attempt to ascertain whether Tunisia's impressive economic performance is likely to continue. In particular, it will assess the medium-term output prospects, with particular reference to the specific supply conditions in various sectors of the economy, expected trends in domestic and external demand, and the likely impact of past investments. The financing of the Fifth Plan (1977-81) would require both a noticeably higher rate of domestic savings mobilization, and a considerably expanded recourse to foreign borrowing. The mission will discuss the investment targets and sectoral priorities of the new Plan, with specific reference to the prospects of mobilizing the needed domestic and external resources, and envisaged policy measures.

The mission will discuss the factors underlying the growth of government revenues and expenditures. Developments in revenues will be analyzed in the light of specific tax measures, the evolution of external trade and economic activity, and the concessions and exemptions granted to encourage private investments. Current expenditure trends will be discussed with reference to public wage policies, the nature and aims of budgetary transfers (especially price subsidies), and objectives in the areas of education and other government services. The main developments in capital expenditure, its implementation and its sectoral allocation, as well as the prospects of expanding capital expenditures will be reviewed. The Government's intentions related to the financing of overall Treasury operations will be discussed.

Over the past four years, the Central Bank has improved its control over the liquidity situation of banks, and taken measures to make banks more responsive to the country's development effort. Banks have been encouraged to use a larger proportion of their resources for medium- and long-term credit to priority economic activities. The mission will examine the implementation of these measures, and discuss their aims and objectives. The role of the banking system under the new Plan will be reviewed with reference to the considerably increased needs of savings mobilization, and the policy measures the authorities are envisaging to achieve it, including a more flexible use of interest rate policy. Monetary developments and likely future trends will be examined in the context of government financing needs, balance of payments developments, economic growth and inflation.

The mission will discuss in detail recent trends and prospects in the country's balance of payments. The factors affecting the evolution of the value and volume of exports will be analyzed. On the basis of available information for calendar year 1976, Tunisia appears to qualify for a purchase under the Compensatory Financing Decision. In case the

Tunisian authorities should express an interest in drawing under the Decision, the mission will obtain the necessary information to enable the staff to determine Tunisia's eligibility. The growth of import payments will be examined in terms of external price trends and domestic demand factors. The reasons for the slow growth or virtual stagnation in net receipts from various services and current transfers will be ascertained. The impact of increasing capital inflows on the country's debt burden will be reviewed. In the context of the new Plan, the prospects for the balance of payments will be discussed, mainly with reference to assumptions underlying the export and import forecasts, the anticipated recourse to foreign borrowing, and the authorities' objectives with regard to external reserves and overall foreign indebtedness.

The mission will review recent developments in Tunisia's trade and payments system, and will discuss the exchange rate policy pursued by the authorities. It will examine prospects for an early implementation of the new Code governing the foreign exchange and trade system, and will stress the desirability of simplifying the existing cumbersome controls. In this context, the mission will explore the feasibility of delegating further approval authority to authorized banks, of easing restrictions on current payments, and of reducing import restrictions.

As Tunisia has not yet accepted the Amendment to the Articles of Agreement and the quota increase, the mission will ascertain the likely timing of the completion of the legislative procedure.

1975

Office Memorandum

CC: Mr. Sweeney

TO : Acting Managing Director

DATE: February 20, 1975

FROM : E.L. Bornemann

SUBJECT : Tunisia - 1975 Article XIV Consultation

RECEIVED FEB 21 1975

A mission consisting of Mrs. Tyler (ETR), Messrs. Basu (AFR), Marrakchi (AFR), and myself visited Tunis during the period February 2-15 1975 to conduct the 1975 Article XIV consultation discussions. The discussions were most efficiently organized by the authorities, and the policy discussions were frank and comprehensive. The mission had meetings with the Minister of Finance (Mr. Fitouri), the Governor of the Central Bank (Mr. Ghenima), and other senior government officials.

After a four-year period of rapid economic growth, the Tunisian economy experienced a sharp slowdown in 1973, as agricultural output and related processing activities suffered from poor climatic conditions and the tourism sector stagnated for the first time in recent years. The Tunisian economy quickly regained its momentum in 1974 with a recovery in agricultural production and a general resumption of expansion in mining, manufacturing, and related exports. Thus, in the first two years of the current Four-Year Plan (1973-76), the annual growth rate of GDP at constant prices averaged slightly more than 6 per cent and was close to the planned target. Although in real terms only about 72 per cent of the investments planned for 1973-74 were realized, with the shortfall due mainly to delays in the preparation and execution of public projects, the overall investment effort as measured by the ratio of real investment to GDP at constant prices has risen steadily, and presently amounts to about 22 per cent. Encouraged by generous fiscal incentives, private investment (in particular, foreign) has exceeded the plan target, which helped to boost manufacturing exports and to exceed the expected increase in employment. Despite a partial attenuation, the financial situation is expected to remain strong in 1975; and prospects of economic growth are favorable for most sectors, with the possible exception of tourism.

The overall fiscal performance has been satisfactory. Consolidated budgetary receipts grew by 42 per cent in 1974, mainly as a result of higher receipts from the petroleum and phosphate sectors, but also partly due to an improved tax collection effort. Growth in current expenditures accelerated to a rate of 24 per cent in 1974, reflecting mainly increases in public sector wages and sharply higher price subsidies for selected imports (such as cereals, sugar, edible oils, and fertilizers). The current surplus nevertheless doubled in 1974 to about D 1.2 billion, representing 31 per cent of government revenues. Over the last two years, capital expenditures increased about threefold and in 1974 amounted to D 1.5 billion. The resulting overall deficits in 1973-74 have been financed to a large extent from nonbank domestic resources. The 1975 budgetary forecasts envisage revenues to rise by 21 per cent and current expenditures by 33 per cent (mainly reflecting continued wage increases and substantially larger budgetary subsidies). Capital expenditures are budgeted to increase by 21 per cent. The Tunisian authorities indicated that increased current budgetary subsidies were not being granted by diverting resources from a presently feasible investment program, and that in the future the amount of budgetary subsidies would be progressively reduced. The overall fiscal deficit is expected to increase substantially in 1975, and its financing is still to be derived mainly from domestic resources (in particular, from increased sales of long-term equipment bonds).

The rate of monetary expansion accelerated sharply in 1974 to about 25 per cent, as the result of a substantial accumulation of net foreign assets and a strong expansion in credit to the private sector. For 1975, the authorities are committed to substantially reducing the rate of monetary expansion, and at the same time to adapting the banking system to the development needs of the economy. In 1974 the Central Bank increased the scope of its participation in the existing interbank money market, and introduced a variety of measures to ensure that deposit money banks would gradually increase their holdings of medium- and long-term loans and equipment bonds. The Central Bank continues to encourage banks to actively participate in the identification and promotion of private sector investment projects. At the same time, it has been taking steps to restrain the rapid expansion of nonproductive short-term credits. Largely in response to pressure from the IBRD, the authorities are undertaking a study of interest rates in Tunisia, with particular emphasis on the advisability of raising the banks' lending rates. The authorities indicated that they may be calling upon the Fund to evaluate the policy conclusions of the study, once the factual part has been concluded.

Tunisia's balance of payments, which has been in overall surplus since 1968, remained strong in 1974. The surplus in that year amounted to about SDR 60 million, reflecting mainly the substantial improvement in Tunisia's terms of trade as prices for the country's exports (mainly petroleum, phosphates, and olive oil) rose by about 66 per cent and exceeded the increase in import prices estimated at about 35 per cent. The only setback was a decline in receipts from tourism. At the end of 1974, gross official reserves amounted to SDR 341 million, equivalent to more than four months of projected 1975 imports. According to official forecasts, the balance of payments in 1975 would weaken substantially, with the overall surplus declining to SDR 10 million as a consequence of an expected worsening in the terms of trade. Although the forecast deterioration appears on the whole realistic, the mission stressed that it was no cause for alarm because of the comfortable level of existing external reserves. Furthermore, as the country's debt structure has improved considerably in recent years, there is a substantial margin for new indebtedness for launching productive projects, particularly if external loans can be contracted at favorable terms as was the case in the recent loans obtained from certain oil-producing Arab countries.

Since January 23, 1974, when the fixed link of the dinar to the French franc was severed, the dinar buying rate for the French franc has been set at a discount to the parity relationship of the franc equal to the premium of the deutsche mark vis-à-vis the French franc from the central rate-parity relationship prevailing for these two currencies prior to the departure of the French franc from the snake; the resulting appreciation vis-à-vis the French franc is then reduced by an adjustment factor of two percentage points. During the discussions, it was learned that the adjustment factor is not fixed but varies according to the circumstances. During certain months of 1974 when the discount of the French franc in relation to the deutsche mark was particularly high, this factor was increased up to five percentage points in order to prevent an excessive appreciation of the dinar. Furthermore, the dinar has not been permitted to appreciate by more than 10 per cent in relation to the French franc or to fall below its previous parity relationship. In terms of classification of Tunisia's exchange rate policy under the Guidelines, Tunisia appears to be a borderline case. In SM/75/30, Tunisia was classified under Category (4), but on the basis of the information received during the consultation discussions, it might also fall under Category (3). This subject was discussed with the Tunisian authorities who appeared generally indifferent to the classification question.

Following a minor effective appreciation of the dinar in 1973, Tunisia's exchange rate policy has resulted in a further effective appreciation of the dinar by about 6 per cent in the period January 1974 to January 1975. With world market prices of Tunisia's main export commodities increasing sharply in 1974, the appreciation of the dinar has not adversely affected the country's competitiveness in export markets; at the same time, the appreciation has had the effect of moderating the domestic impact of rising import prices.

During 1974 Tunisia eliminated virtually all remaining bilateral payments agreements, and some progress was also made in simplifying and liberalizing payments for current invisibles. With no further liberalization of import restrictions, the overall exchange and trade system remains complex and comprehensive. The mission welcomed the authorities' intention to streamline and codify the complicated rules affecting the exchange and trade system, and to increase the number of commodities that can be imported freely. It stressed, however, that in view of Tunisia's comfortable reserve position the opportunity should be used for a substantial further liberalization and simplification of existing restrictions on imports and current invisibles.

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INTERNATIONAL MONETARY FUND

TUNISIA

Briefing Paper - 1975 Article XIV Consultation

Prepared by the African Department and the Exchange and Trade Relations Department

(In consultation with the Legal Department and the Treasurer's Department)

Approved by Charles L. Merwin and Timothy Sweeney

January 28, 1975

A mission consisting of Mr. E.L. Bornemann (head), Mrs. M. Tyler (ETR), and Messrs. A. Marrakchi (AFD) and A. Basu (AFD) will visit Tunis during the period February 2-15, 1975 to conduct the 1975 Article XIV consultation discussions.

I. Relations with the Fund

Tunisia became a member of the Fund on April 14, 1958. Its original quota of SDR 12 million was increased to SDR 48 million at the time of the Fifth General Review of Quotas. The initial par value of the Tunisian dinar of D 0.525 = SDR 1 was agreed with the Fund on September 28, 1964 and has since remained unchanged. Until January 23, 1974, the rate of the dinar in relation with the French franc had remained fixed. Since then, the dinar buying rate for the French franc has been set at a discount to the parity relationship of the franc expressed in dinars equal to the premium of the deutsche mark in Paris, reduced by two percentage points. Rates for other currencies are determined on the basis of the cross rates prevailing in the major foreign exchange markets. In the view of the staff, Tunisia's exchange rate policy falls under Category IV of the Guidelines.

Tunisia has been granted six consecutive stand-by arrangements by the Fund, the last of which expired in December 1970. Purchases under these arrangements totaled the equivalent of SDR 51.3 million. Since the expiration of these stand-by arrangements, Tunisia has reduced the Fund's holdings of Tunisian dinars to the present level of 75 per cent of quota.

Tunisia has received SDR allocations totaling SDR 14.7 million, and has used SDR 10.2 million, mainly in repurchases from the General Account and also for payments of charges. Tunisia acquired SDR 2 million in October 1971, SDR 1 million in February 1972, and SDR 1 million in September 1974 by way of designation; under the current designation plan, Tunisia could be designated for a maximum of SDR 2 million. At the end of December 1974, Tunisia's holdings of SDRs were equivalent to 58 per cent of its net cumulative allocation.

Tunisia has received technical assistance under the Bureau of Statistics' Central Bank Bulletin Project and a fiscal expert visited Tunisia for a one-year period ending in September 1974 to assist in the field of management and control of Treasury operations. The last Article XIV consultation discussions with Tunisia were held in Tunis in August 1973. The staff report (SM/73/254) was considered by the Executive Board on February 1, 1974.

II. Recent Economic Developments

Following a four-year period of rapid economic growth stimulated by high rates of expansion in tourism, manufacturing, agriculture, and commerce, the Tunisian economy experienced a sharp slowdown in 1973, reflecting major setbacks in agricultural production and tourism, and a virtual stagnation in most other productive sectors. The economy resumed its rapid expansion in 1974, when the growth rate of GDP in real terms exceeded the average of the 1969-72 plan period (9.7 per cent), amounting to almost 11 per cent. The expansion reflected a 12 per cent increase in agricultural production, and exceptionally high growth rates in manufacturing, in mining and energy, and in construction and public works. The diversified growth of the economy was stimulated by a relatively high rate of investment to nominal

GDP, which after averaging about one fifth during 1969-72, rose to 24 per cent by 1974. The increased investment effort of the last two years was accompanied by a sharply declining ratio of the external deficit in goods and nonfactor services to nominal GDP, owing to an appreciable improvement in the terms of trade stemming mainly from higher prices for the country's exports of phosphates and petroleum products. The latter factor also contributed to substantial improvements in the fiscal situation and the balance of payments in 1974.

According to preliminary official estimates, a slower growth rate of about 8.7 per cent is forecast for 1975, mainly because agricultural output (particularly of olives and cereals) is expected to be adversely affected by the dry climatic conditions of recent months. Related agricultural processing activities are also predicted to contribute to the slowdown. Among the principal nonagricultural exports, the output of crude oil is expected to increase marginally from 4 million tons to about 4.3 million tons, while that of phosphates is expected to rise more appreciably by 17 per cent to 4.5 million tons. Despite the overall weaker production performance, investments are forecast to increase by almost 22 per cent to about 27 per cent of nominal GDP, with the corresponding share of consumption remaining virtually unchanged. Accordingly, the resource gap would widen to somewhat less than 4 per cent of GDP, though also partly reflecting an attenuation of the past year's terms of trade gain. These developments would be accompanied by substantially reduced fiscal and balance of payments surpluses.

Over the last two years, there have been increasing pressures on prices, owing mainly to rising costs of imported goods and to an upward drift in private and public wages. Notwithstanding increasingly heavy budgetary subsidies for the stabilization of prices of basic foodstuffs (cereals, milk products, meat, and edible oil), the annual rate of increase in the consumer price index doubled to an average of about

4.5 per cent during 1973-74. In these years the cost of investment also rose sharply, reflecting an average annual increase of 14 per cent in the prices of imported equipment goods.

Tunisia's Fourth Development Plan (1973-76) envisages a doubling of investments over the previous Plan to D 1.3 billion, with a view to achieving an average annual growth rate of 6.6 per cent. Approximately 42 per cent of the investments were targeted for the first two years and although this was achieved, in real terms the rate of realization was substantially lower because of delays in the execution of public projects and unforeseen increases in costs of imported equipment. According to revised estimates, about 83 per cent of the total investment is to be financed from domestic resources as compared with an initial estimate of about 76 per cent; the revision reflects the substantially improved public savings prospects stemming mainly from higher petroleum prices. In contrast to the Third Plan (1969-72), the Fourth Plan allocates slightly more than half the investments to the productive sectors, with particularly increased emphasis to manufacturing and petroleum production, and to transport and infrastructure among other sectors. In order to encourage investments in the private sector , which is to account for more than half the total investments in the three years 1973-75, the Government has taken a number of measures to attract foreign private capital to Tunisia.

According to official estimates, the Central Government registered a current surplus of D 102.1 million in 1974, equivalent to about 27 per cent of consolidated current receipts and to almost twice the 1973 surplus. The additional petroleum based revenues, which amounted to D 57.3 million, accounted for more than half of the 1974 increase in total revenues, and fully covered the entire increase in current expenditures which rose by about 26 per cent. The rise in current expenditures reflected a 22 per cent growth in public wage payments and an approximately 58 per cent increase in budgetary subsidies for price support. The Central Government's capital expenditure was estimated to rise by 54 per cent, which would be almost twice the 1973 rate of expansion. As a result of these developments, the overall deficit, after registering a 49 per cent increase in 1973, was expected to decline only marginally to about D 32.5 million in 1974. The share of internal financing of this deficit was estimated to improve markedly to 70 per cent in 1974.

In 1975 consolidated central government receipts are projected to rise by about 10.6 per cent and current expenditures by almost 18 per cent, resulting in a 9 per cent reduction in the current surplus. With capital expenditures estimated to increase further by 18.5 per cent, the overall fiscal deficit would be about D 58.3 million. More than 80 per cent of the deficit is expected to be financed from domestic resources, largely from sales of government equipment bonds to the private nonbanking sector.

The rate of monetary expansion averaged around 16 per cent during 1972-73, and based on available information it appears to have expanded at about the same rate through 1974. Although through 1973-74 there have been sharp successive reductions in the Government's net indebtedness to the banking system, overall domestic credit has expanded at an average annual rate of about 14 per cent. This resulted from a strong increase in credit to the private sector, consistent with the Government's objective to promote private initiative. Net foreign assets also accumulated at a relatively high rate over the last two years. With a predicted growth in net foreign assets of about 3 per cent in 1975, the Government expects a rate of monetary expansion of about 19 per cent.

Tunisia's balance of payments, which has been in overall surplus since 1968, remained strong in 1974. Indeed, in that year the surplus rose by SDR 22 million to an estimated SDR 86 million, after having decreased somewhat in each of the preceding two years from the record high of over SDR 90 million in 1971. The favorable outcome in 1974 stemmed largely from a decline of SDR 34 million in the trade deficit, mainly reflecting the substantial improvement in Tunisia's terms of trade as prices for the country's exports (mainly crude petroleum, olive oil, and phosphates) rose by about 66 per cent and exceeded the increase in import prices, estimated at about 35 per cent. The value of exports grew by 87 per cent, and of imports by 53 per cent. Net receipts from unrequited transfers rose by SDR 6 million due largely to new grants from oil-producing Arab countries. These gains were offset only partly by a decline by SDR 18 million in the surplus on the services account as net receipts from tourism fell for the first time in recent years, while payments for a number of services accelerated, such as freight, insurance, dividends, and interest. Net capital inflow, at SDR 55.6 million, remained virtually unchanged from its 1973 level. At the end of 1974, gross official reserves amounted to SDR 346 million, representing about five months of projected 1975 imports.

According to official Tunisian forecasts, the balance of payments in 1975 would weaken substantially, with the overall surplus declining by SDR 76 million to SDR 10 million. As in 1974, the determining factor is the trade account; the trade deficit is expected to increase by SDR 67 million, as a consequence of an expected worsening in the terms of trade. Exports are forecast to rise by only 7.5 per cent, with prices on average to remain at their 1974 level, while imports are projected to increase by 15 per cent, of which 9 per cent would be accounted for by price increases. Net receipts from services are forecast to decline by SDR 6 million, thus continuing the downward trend begun in 1974. The net inflow from unrequited transfers is expected to remain virtually unchanged, and net capital inflow to decline slightly due to lower direct investment and stepped up repayments of official loans.

The structure of Tunisia's external debt has continued to improve. Amortization and interest payments in 1974 were equivalent to about 9 per cent of receipts from exports of goods and services, compared with 15 per cent in 1972 and 25 per cent in 1969.

Since the previous consultation discussions, Tunisia has made major progress in reducing reliance on bilateralism. Bilateral payments agreements with nine countries (including two Fund members--Egypt and Romania) were terminated, thus leaving India the only country with which a bilateral payments agreement continues to be maintained. In addition, Tunisia relaxed somewhat controls and restrictions on payments and transfers for current and capital international transactions. Regarding the import regime, however, some reversal has apparently occurred in the progress made during 1971-73 toward liberalizing and simplifying the system. A number of commodities were removed from the list of those which may be imported freely against "import certificates" by specified importers, and a number of imports were added to the "prohibited" list. Overall exchange and trade controls remain complex and comprehensive.

III. Topics for Discussion

In reviewing the overall economic and financial performance since the last consultation discussions, the mission will pay special attention to recent trends and immediate prospects for the output of key exports such as petroleum, phosphates, and olive oil with a view to ascertaining the likely future trend in real exports. The likely production trends in domestic consumption items, especially of foodstuffs and raw materials, will be discussed in relation to its envisaged impact on the future growth of real imports. Overall consumption trends will be discussed with reference to the likely impact of the Government's increased wage payments and higher subsidies for essential commodities.

Investment targets of the 1973-77 Plan will be reviewed with particular reference to the increased costs of imported equipment goods, the problems and delays in project execution, the financial health of the major productive enterprises, and the Government's present policies of granting subsidies and other fiscal incentives to the enterprise sector. The envisaged sectoral impact of the allocation of investments in terms of output and employment will be assessed. The underlying financial strategy of the Plan will be discussed in terms of the likely need for external resources over the two remaining years of the Plan, and in terms of the prospects of domestic savings mobilization.

The main factors underlying the recent rise in prices will be analyzed with particular reference to the impact of higher prices of imported goods and to trends in the domestic supply situation. The rationale for existing price policies, especially of increased budgetary subsidies will be reviewed.

The mission will discuss the factors underlying recent growth trends in fiscal revenues and expenditures. The likely evolution of fiscal receipts over the remaining two years of the present Plan will be discussed in the light of prospects of petroleum based revenues, new fiscal measures, if any, and in terms of the envisaged expansion of external trade and economic activity. The mission will also inquire what progress is being made with the Government's long-standing efforts to reform the tax system. The role of fiscal incentives to encourage private investors will be ascertained. The main developments in expenditures, especially in the major areas of public wage payments, budgetary subsidies, and capital expenditures will be discussed. In view of the continued accumulation of government deposits at the Central Bank during 1974, the mission will ascertain whether this was the result of a deliberate policy action aimed at restraining the rate of monetary expansion as in earlier years or whether it reflected delays in the implementation of the Government's investment program.

In discussing monetary and credit policy, the mission will try to assess the results of the modification in monetary policy instruments introduced in 1973-74 to improve the control over the banks' liquidity. As the current Plan attaches considerable emphasis to the mobilization of domestic financial resources and their channelling in the form of medium- and long-term credits for the economic activities which have been assigned priority, the mission will seek information as to what concrete steps have been taken, or are under consideration, to make the banks more responsive to the country's development effort. Monetary prospects for 1975 will be reviewed with the authorities.

The mission will discuss the exchange rate policy that Tunisia has pursued since terminating the fixed link with the French franc, which has resulted in a further effective appreciation of some 2 per cent in 1974. It will review any changes in the mechanism used to fix the rate for the dinar. In discussing recent balance of payments developments and prospects, the reasons behind the slow growth or stagnation of export volumes will be examined. The mission will also examine the projected worsening of Tunisia's terms of trade for 1975.

In view of the strength of the balance of payments and Tunisia's reserves position, a substantial reduction of existing restrictions on imports and payments and transfers for current international transactions should be undertaken without further delay. In particular, now that the new and more flexible customs tariff has been in operation since July 1973; the mission will press for the long delayed liberalization of import restrictions. In this connection, the mission may inform the authorities that it would be difficult for the Fund to justify to GATT the present level of import restrictions on balance of payments grounds.

The mission will inquire as to Tunisia's position with regard to the Voluntary Declaration on Trade and other Current Account Measures.