FOR AGENDA

SM/84/118

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May 23, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Tunisia - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Tunisia. A draft decision appears on page 17.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Sacerdoti (ext. (5)8514) or Mr. Rothman (ext. (5)8512).

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INTERNATIONAL MONETARY FUND

TUNISIA

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the 1984 Article IV Consultation with Tunisia

Reviewed by the Committee on Article IV Consultations

Approved by Louis M. Goreux and S. Kanesa-Thasan

May 22, 1984

I. Introduction

The 1984 Article IV consultation discussions with Tunisia were held in Tunis during the period March 20-April 3, 1984. The Tunisian representatives included Messrs. M. Belkhodja, Governor of the Central Bank; S. M'Barka, Minister of Finance; I. Khelil, Minister of Planning; R. Sfar, Minister of the National Economy; L. Ben Osman, Minister of Agriculture; E. Chelbi, Minister of Tourism; and other senior officials of ministries and agencies concerned with economic and financial matters. The staff representatives were Messrs. Ch. François (head-AFR), S. Rothman (AFR), E. Sacerdoti (AFR), P. Wickham (RES), M. Dairi (AFR), and Ms. C. Elwell (secretary-AFR). Mr. G. Salehkhou (Executive Director for Tunisia) attended the concluding meetings.

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

II. Recent Economic and Financial Developments and Policies

Following a prolonged period of relatively rapid real economic growth, domestic financial stability, and a generally strong balance of payments position, associated largely with buoyant petroleum exports, Tunisia's economic and financial performance has recently weakened. While exogenous factors such as unfavorable weather conditions and slackened external demand have dampened overall economic activity and exports of goods and services, 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 stagnated, while consumer-price inflation accelerated from 9 percent to almost 14 percent (Table 1). The average annual increase in wages and salaries was 23 percent, and the consolidated fiscal deficit doubled as a percentage of gross national product

Table 1. 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. 1/	32.9	13.1	-13.9	-2.8	5.1
Of which: nonenergy	(13.2)	(20.8)	(-0.5)	(-0.5)	(13.7)
Imports, c.i.f. 1/	26.3	15.1	-4.2	-5.3	5.2
Of which: nonenergy	(19.0)	(18.5)	(6.1)	(-5.3)	(3.4)
Terms of trade (deterioration -)	14.3	7.8	-2.9	-6.1	-2.1
Nominal effective exchange rate (depreciation -) 2/	2.0	3.0	-2.7	-0.1	...
Real effective exchange rate (CPI based) (depreciation -) 2/	-1.5	-0.9	-1.2	-0.7	...
Real effective exchange rate (WPI based) (depreciation -) 2/	-1.1	-0.1	8.0	-0.7	...
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	7.00 3/
12-18 month time deposit	5.25	7.00	7.00	7.00	7.00 3/
General rediscountable advances	7.0-7.5	8.0-8.5	8.0-8.5	8.0-8.5	8-0-8.5 3/
			(Ratios; in percent of GNP unless otherwise indicated)		
Central government consolidated deficit (-)	-2.8	-2.5	-5.1	-5.5	-7.6
Domestic bank financing	(--)	(0.6)	(0.9)	(0.6)	(2.1)
Gross fixed capital formation	27.8	30.9	31.4	29.4	28.2
Gross national savings	24.1	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	13.6	14.8	15.7	16.5
Gross official international reserves (in months of imports, f.o.b.)	2.5	2.1	2.5	2.6	(March) 1.9
			(In millions of SDRs)		
Overall balance of payments	63	83	25	14	--
Gross official international reserves (at end of period)	469	467	556	548	(March) 417
External public debt	2,322	2,654	2,974	3,237	3,680

Sources: Data provided by the Tunisian authorities; and staff projections.
1/ Customs basis.
2/ Weighted by total trade (excluding petroleum) plus tourism.
3/ As of end-April.

(GNP) to 5.1 percent, as the rise in expenditures accelerated to 32 percent (Chart 1). Moreover, the government domestic bank borrowing requirement was significantly larger; bank credit to the economy (the private and nongovernment public sectors) rose by 24 percent; and money plus quasi-money increased by 19 percent. Due mainly to a drop in petroleum exports and a rise in nonenergy imports, the current account deficit in the balance of payments (excluding official transfers) widened to the equivalent of 8.3 percent of GNP (from 5.0 percent in 1980 and 5.8 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 appreciation of the U.S. dollar vis-à-vis the Tunisian dinar 1/, Tunisia's external public debt rose from 38 percent of GNP in 1981 to 41 percent in 1982.

Based on preliminary data, real GDP is officially estimated to have increased by 4.5 percent in 1983. Although the prolonged drought continued to depress agricultural output, marked increases were recorded in manufacturing output (9 percent) and energy production (7 percent). The rise in consumer prices moderated to 9 percent, but this deceleration was achieved in part by a "voluntary" 6-month reduction in some prices and by an intensification of price controls, which had followed a period of price liberalization designed to improve the efficiency of resource allocation.

There was a further large increase in wages and salaries (16 percent), and, although the growth of government expenditure moderated to 15 percent, the consolidated fiscal deficit increased to 5.5 percent of GNP. Also, with the exception of companies engaged in petroleum-related activities, the nonfinancial public enterprises continued to incur considerable operating losses. For a sample of 46 important enterprises, these losses amounted to almost 1 percent of GNP in 1983. Growth in credit to the economy remained high (20 percent), and the increase in money plus quasi-money (18.5 percent) again exceeded the growth in nominal GNP (12.7 percent). 2/ Interest rates have not been changed, for the most part, since April 1981, and remain generally slightly negative in real terms.

Both private and public consumption continued to increase rapidly, and the ratio of national savings to GNP declined further to 22.0 percent (from 23.0 percent in 1982 and 24.7 percent in 1981). The investment ratio also declined, by 2 percentage points to 30 percent of GNP (Chart 2).

Regarding the external accounts, estimates indicate a slight decline in 1983 in the current account deficit in terms of GNP (to 7.8 percent). Exports (on a customs basis) declined marginally (by 2.8

1/ At end-March 1984, D 1 = SDR 1.3219.

2/ At end-1983 credit to the Government and to the nonfinancial public enterprises is estimated at 40 percent of total domestic credit.

percent) in SDR terms, due mainly to decreases in agricultural and energy exports. On the other hand, imports fell by 5.3 percent as a result of declines in the investment goods, primary and semifinished products, and energy categories, as food and other consumption imports rose sharply. The containment of overall imports, however, was achieved in part by a tightening of import controls. The slight decline in the trade deficit was offset by a deterioration in net services and transfers stemming from a tapering-off of workers' remittances and tourism receipts and rising interest payments (Table 2). Both direct foreign investment and loans from official creditors were well below their 1982 levels, and larger recourse was made to other forms of external financing, especially medium-term loans (including those from the international financial markets). The overall balance of payments recorded a modest surplus (SDR 14 million), although it was smaller than in 1982 (SDR 25 million).

In 1983 Tunisia's external public debt rose to SDR 3.2 billion and, with a further large appreciation of the U.S. dollar during the year, to 45 percent of GNP. The bulk of Tunisia's external debt is effected by the Government and other public sector institutions, and the contracting of such debt is controlled by the Ministry of Finance and the Central Bank. Tunisia's debt service ratio for 1983 is estimated at 15.7 percent. At end-1983 Tunisia's gross official international reserves were equivalent to 2.6 months of imports (f.o.b.).

The exchange rate of the Tunisian dinar is determined with reference to a basket of currencies containing the U.S. dollar, the French franc, the deutsche mark, and the Italian lira. During 1983 the nominal effective exchange rate was essentially unchanged, and the real effective exchange rate adjusted for relative movements in consumer prices depreciated by 0.7 percent. The real effective exchange rate adjusted for relative movements in wholesale prices also depreciated by 0.7 percent in 1983 following a sharp appreciation (8 percent) in 1982 (Chart 3). 1/ Vis-à-vis the SDR, the dinar depreciated by 10.2 percent in the period between end-1982 and end-March 1984.

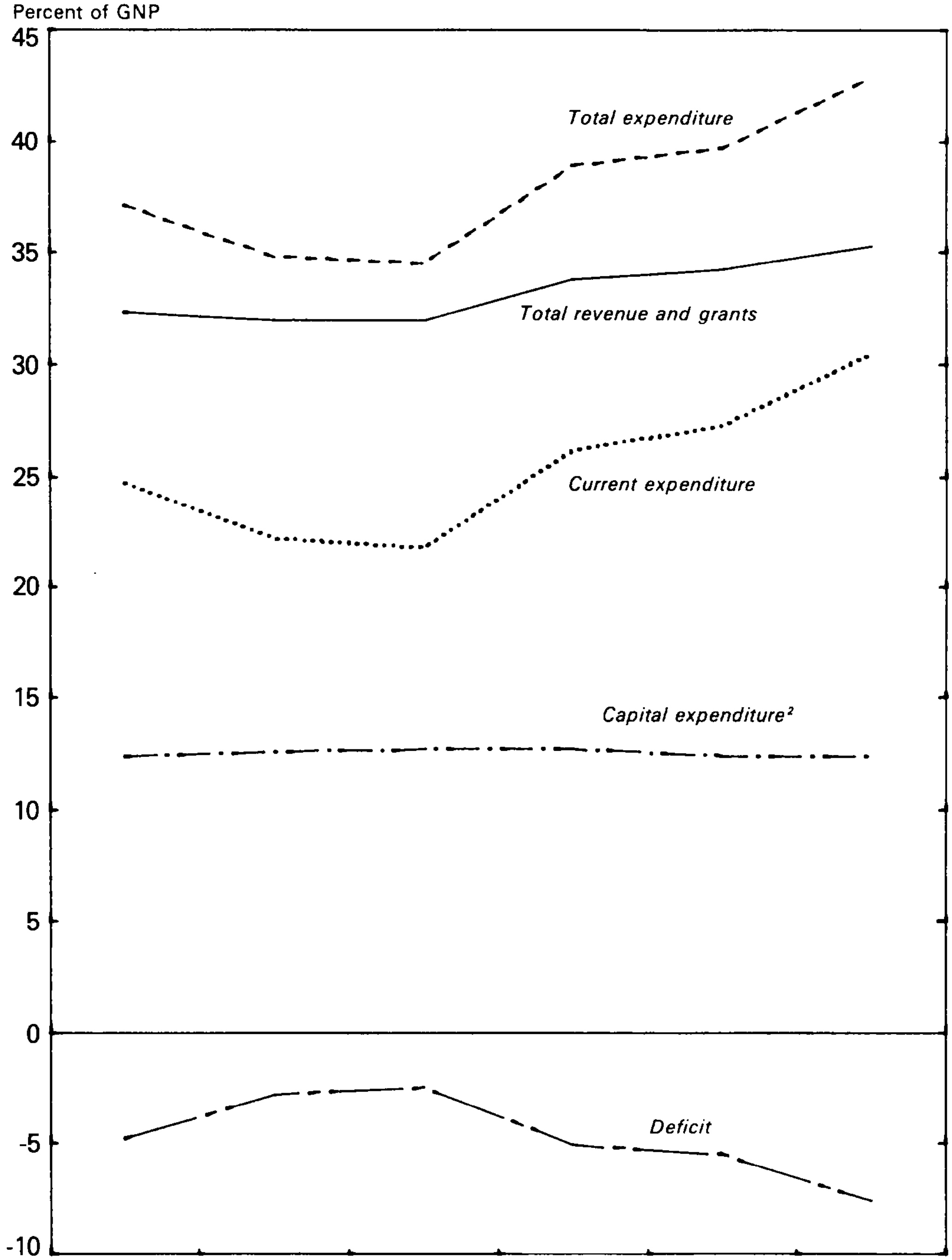
Tunisia maintains a relatively complex exchange and trade system. The sale of foreign exchange continues to be limited for most invisibles, and payments for nonliberalized imports require prior authorization. Also, trade restrictions arise from the continued licensing of some imports. Over the past few 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 import limits were tightened for industrial inputs

1/ In view of Tunisia's consumer price control system, real effective exchange rates using domestic wholesale rather than consumer price indices as deflators are considered preferable indicators of changes in competitiveness.

CHART 1

TUNISIA

CONSOLIDATED FINANCIAL OPERATIONS OF THE CENTRAL GOVERNMENT, 1979-84

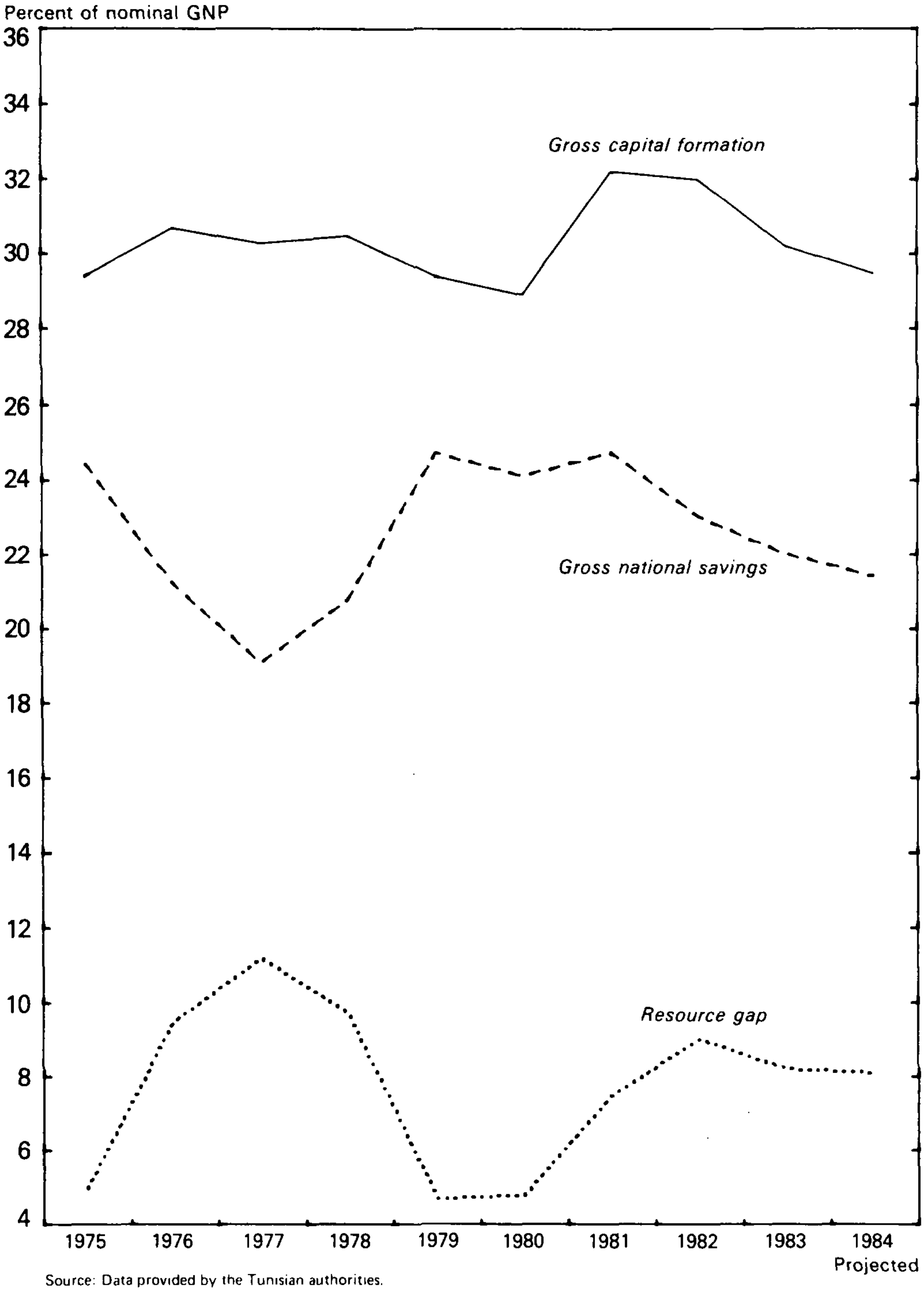


Source: Data provided by the Tunisian authorities.
[1]Budget.
[2]Includes direct investment, capital transfers, participations, and net lending.

CHART 2

TUNISIA

INDICATORS OF CAPITAL FORMATION AND SAVINGS, 1975-84



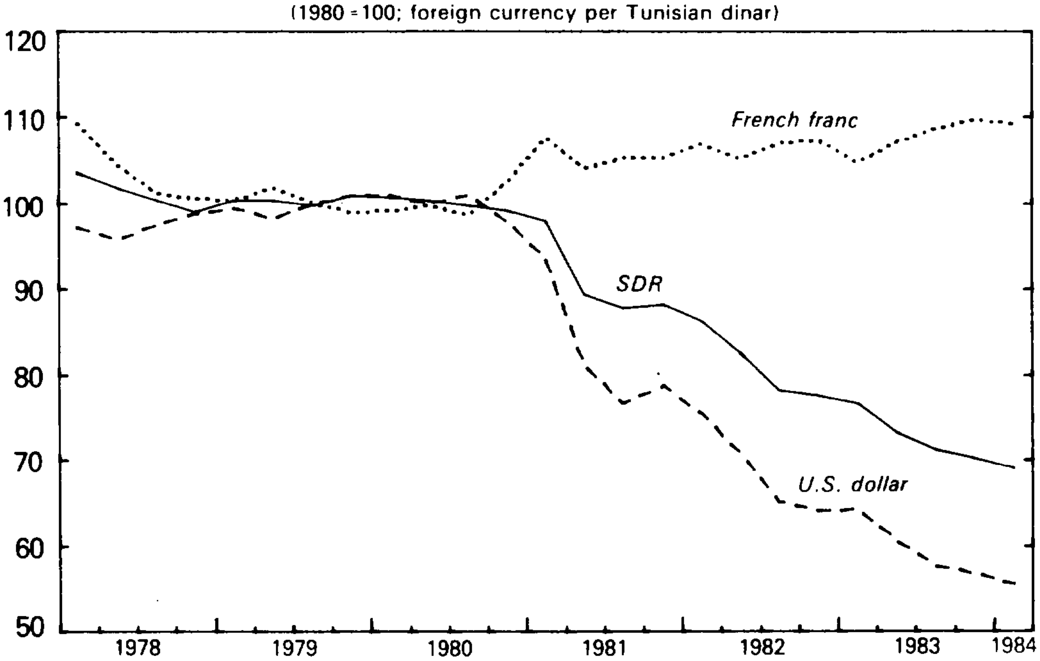
Source: Data provided by the Tunisian authorities.

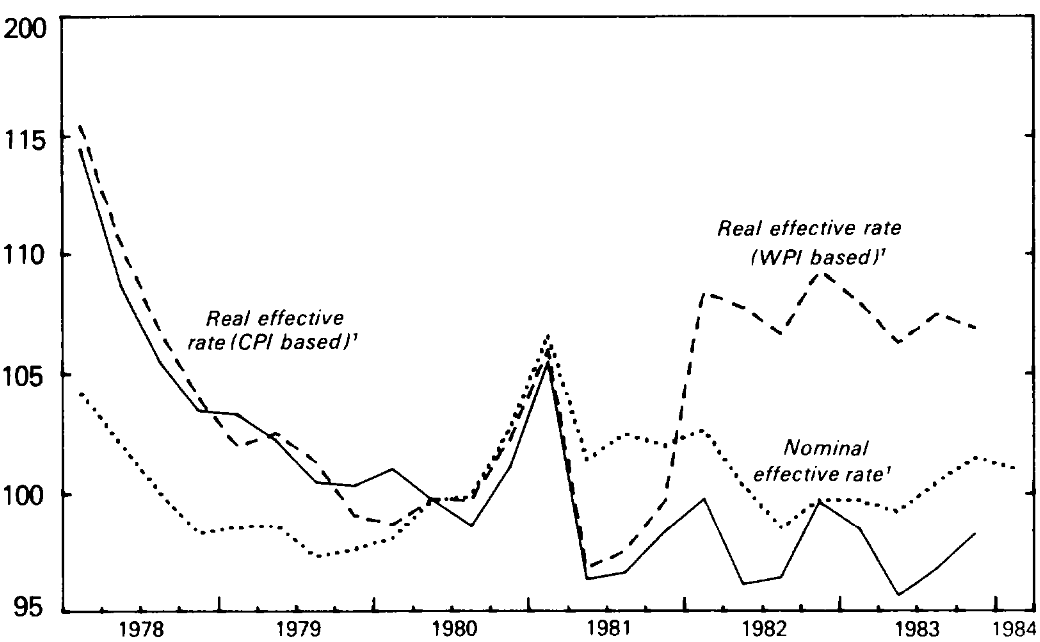
CHART 3

TUNISIA

INDICES OF SELECTED EXCHANGE RATES, 1978-84

(1980 = 100; foreign currency per Tunisian dinar)





Source: IMF Data Fund

[1] Weighted by total trade (excluding petroleum) plus tourism.

Table 2. Tunisia: Balance of Payments and External Debt, 1981-88

(In millions of SDRs)

	1981	1982	1983 Prelim.	1984	1985	1986	1987	1988
				Projections				
Balance of payments								
Exports, f.o.b.	1,789	1,472	1,472	1,540	1,655	1,790	2,050	2,330
Imports, f.o.b.	-2,696	-2,642	-2,578	-2,670	-2,945	-3,290	-3,700	-4,180
Services and transfers (net)	493	544	513	480	555	670	690	740
Current account deficit	-414	-626	-593	-650	-735	-830	-960	-1,110
(In percent of GNP)	(-5.8)	(-8.3)	(-7.8)	(-8.1)	(-8.1)	(-8.2)	(-8.3)	(-8.6)
Grants	17	15	21	20	20	20	20	20
Direct and portfolio investment	313	365	193	235	235	230	220	220
Medium- and long-term loans (net)	237	272	386	395	480	580	720	870
Disbursements								
Official creditors	276	330	276	290	300	310)	1,135	1,330
Private creditors	240	227	414	430	520	640)		
Amortization	279	285	303	325	340	370	415	460
Short-term capital	-76	-1	7	--	--	--	--	--
Capital account	491	651	607	650 1/	735 1/	830 1/	960 1/	1,110 1/
SDR allocation	6	--	--	--	--	--	--	--
Overall balance	83	25	14	-- 1/	-- 1/	-- 1/	-- 1/	-- 1/
Debt service								
Total service payments	459	470	482	534	574	659	795	900
Principal	280	285	303	326	339	372	415	460
Interest	179	185	179	208	235	287	380	440
Debt service ratio 2/	13.6	14.8	15.7	16.5	16.2	16.9	18.0	18.1
External debt (disbursed)								
Amount outstanding	2,654	2,974	3,237	3,632	4,112	4,692	5,412	6,282
In percent of GNP	38.2	41.2	44.8	45.1	45.2	45.7	46.9	48.4
Memorandum items:								
Exports of goods and services and private transfers	3,376	3,183	3,081	3,241	3,548	3,905	4,420	4,960
Net energy exports (customs basis)	476	483	465	404	397	343	310	290
Consumption/GNP	75.3	76.9	78.0	78.6	79.0	79.0	80.1	80.5
Investment/GNP	32.2	32.1	30.2	29.5	29.5	29.3	28.2	28.1
Imports of goods and services/GNP	49.7	46.4	43.7	43.3	42.4	41.8	41.9	42.1
Exports of goods and services/GNP	41.3	36.2	34.9	34.7	34.0	33.5	33.9	34.1

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

1/ As it is expected that over the 1984-88 period Tunisia would not encounter difficulties in financing its current account deficit, overall balance of payments equilibrium is projected.
2/ In percent of exports of goods and services and private transfers.

and imports of nonessential consumer goods by wholesalers and retailers. For industrialists, annual import authorizations were initially limited to 80 percent of the 1982 level, but authorizations for an additional 20 percent of the 1982 level were granted in the second half of the year. Regarding payments restrictions and procedures for invisibles, there has been a gradual easing in recent years, especially for allowances for travel and study abroad.

III. Report on the Discussions

The mission took place against a backdrop of political and social uneasiness, following widespread unrest in early January associated with announced increases of about 100 percent in bread prices (subsequently rescinded) in the Government's attempt to eliminate cereal subsidies (amounting to some 2.5 percent of GNP). Although the mission examined in detail the outlook for 1984, the focus of the discussions was on medium-term policies that would enable Tunisia to maintain a viable balance of payments and debt posture.

1. Outlook for 1984

Real GDP is officially projected to rise by 5.5 percent in 1984, under the assumptions of a more normal level of agricultural production and continued rapid growth in manufacturing output. At the same time, consumer prices are forecast to rise by less than 8 percent on a December-December basis, despite increases in several administrative prices, after a 6 percent increase in 1983. However, close "supervision" over retail prices will be maintained, as the authorities' attempt to implement wage restraint is tied to their ability to contain the rise in consumer prices to a modest rate. The rate of growth in both nominal GDP and GNP is forecast at about 12.5 percent.

In the financial area, despite a number of actions taken in the fiscal field after the rollback in bread prices, the overall fiscal deficit is projected to rise further to 7.6 percent of GNP, as government receipts and expenditures are foreseen increasing by 16 percent and 21 percent, respectively. Moreover, with another sharp rise anticipated in domestic credit (17 percent), money plus quasi-money is forecast to rise by 18 percent.

The external current account deficit is expected to widen to SDR 650 million, or to 8.1 percent of GNP, with modest growth (about 5 percent) projected for both exports and imports in SDR terms and a further deterioration foreseen for net services and transfers. On the export side, appreciable gains are anticipated for agricultural products, phosphate derivatives and other chemicals, and textile and leather products, while a further small drop is forecast for petroleum exports. For imports, the largest increases are projected for energy and primary and semifinished products, while investment goods and food and other consumer goods are forecast at about their respective 1983 levels. The control on imports of nonessential consumer goods will not be relaxed in 1984. For industrial inputs, however, a change of the system of annual import authorizations was implemented toward the end of 1983, allowing a carry-over into the next year of any unused margin. Moreover, in view of the low levels of stocks in some areas, in early 1984 the authorities increased annual import authorizations. Receipts from tourism are projected to be essentially unchanged, as are workers' remittances, while interest payments are expected to rise further. Direct investment is projected to recover somewhat, but external borrowing, especially by the Government, is still expected to increase. Overall, balance of payments equilibrium is projected. However, during the first quarter of 1984, due in part to seasonal factors, gross official international reserves declined by SDR 131 million to a level equivalent to 1.9 months of projected 1984 imports. Tunisia's debt service ratio in 1984 is projected at 16.5 percent.

2. External sector prospects and policies

At the outset the mission cautioned the Tunisian authorities that, based on present policies and an extrapolation of current trends, the external accounts would likely become unsustainable over the medium term. Therefore, the mission examined with the Tunisian authorities a "normative" balance of payments scenario through 1988, the major premises of which were that the authorities could effect major macro-structural changes, including containing consumption growth approximately in line with that in GNP, reducing investment and imports relative to GNP, and spurring agricultural and industrial exports. The scenario took into account the projected further decline in net energy (predominantly petroleum) exports. Such net exports, which averaged SDR 461 million over the period 1980-83, are expected, barring new discoveries, to fall steadily over the 1984-88 period to about SDR 300 million. Energy exports are to remain relatively stable, while imports are projected to rise at gradually moderating rates. The scenario resulted in a gradual but modest increase in the current account deficit, from 7.8 percent of GNP in 1983 to 8.6 percent in 1988, and in an increase in the debt service ratio of about 2.5 percentage points to 18.1 percent by 1988.

The Tunisian authorities did not foresee any problems in fully financing the projected current account deficits through 1988. Direct and portfolio investment was conservatively projected at below the levels of the previous few years. Moreover, only marginal increases were forecast for official loans. On the other hand, loans from private creditors (including the international capital markets) were anticipated to increase relatively rapidly, but the Tunisian authorities cited the country's favorable credit rating in support of this projection.

Despite the projected increase, Tunisia's debt-service burden through 1988 would remain manageable. Nevertheless, the authorities recognized 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 international capital markets.

In view of the outlook for a decline in net petroleum exports, the mission focused on prospects for nonenergy exports. Projections, based mainly on anticipated increases in production capacity and the assumption that Tunisia is successful, through its export promotion policies, in increasing its share of nonpetroleum world exports, show nonenergy exports growing on average by about 15 percent per annum (8 percent in volume terms) over the 1984-88 period. The most significant contributions would come from textile and leather products and phosphate derivatives and other chemicals, which, together, would account for about two thirds of total export growth. Smaller but nevertheless important increases are forecast for exports of mechanical and electrical products and agricultural commodities. On the service account, tourism receipts are projected to pick up rapidly after 1984, but workers' remittances are foreseen increasing only modestly (about 4 percent per annum).

In light of the ambitious export goals, as well as the need to contain import growth while permitting a desired easing of the extensive restrictive system, the mission stressed the need for an appropriate exchange rate policy. In this regard, at the request of the Tunisian authorities, the Fund staff prepared several comprehensive exchange rate indicators (using various price indices and measures of labor costs) to guide the authorities in their exchange rate policies. As indicated in Table 1 and Chart 3, movements in the wholesale price index-based effective exchange rate suggest an erosion of Tunisia's competitiveness over the past two years on the order of 7 percent. Therefore, the mission recommended that exchange rate policy be conducted in a manner to offset the appreciation since 1981 and prevent future real appreciations. The Tunisian authorities expressed reluctance to offset the appreciation with a discretionary change in the dinar, preferring instead to allow anticipated domestic wage and price stability in 1984 to reverse the erosion in competitiveness. Moreover, they were concerned about the possible adverse impact on prospective foreign investment of a discretionary depreciation in the dinar. They added that, in order to provide exchange rates more conducive to export growth and import restraint, they intended shortly to adopt a larger currency basket (consisting of eight currencies) to which to peg the dinar. Regarding other policies to spur export growth, the Tunisian authorities emphasized that they had already implemented measures on a wide front, including the creation of export-promotion companies, favorable financing arrangements, and export insurance facilities. More economic integration of the Maghreb could provide important opportunities for industrial development and exports, owing to the economies of scale that such a market would generate.

On the other hand, the Tunisian authorities noted that a more restrictive approach by the EEC could sharply limit prospects for Tunisian exports. Textile exports to the EEC were subject to an agreement of "self-limitation," and goods processed in Tunisia with raw materials imported from the EEC, which previously had been largely exempted from these "limitations," were now subject to them. For olive oil, the Tunisian authorities noted that the prospective entry of Portugal and Spain into the EEC may lead to a surplus of olive oil production within the EEC and thus to restrictions on Tunisian exports.

3. Financial policies

a. Fiscal policies

For 1984 the Tunisian authorities stressed the attempts being made to contain the deterioration in the budgetary position. After the rollback in the announced price increases for bread, a number of measures were adopted. On the revenue side, these included a tax on travel abroad; increases in selected import duties; additional taxes on luxury products, beverages, and tobacco; new fees and charges; and a "second account," which increased from 20 percent to 40 percent the advance payment of taxes due on profits of banks and petroleum companies. The estimated yield from these measures is D 74 million, or just over 1 percent of projected GNP. Overall, government receipts are projected to increase by 16 percent in 1984 (14 percent in 1983), but about one half of the increase would be of a nonrecurring nature--receipts from the speed up of profits tax collections and from the exceptional profits of the Central Bank of Tunisia (BCT) in respect of revaluation gains in 1983.

On the expenditure side, efforts have been made to pare capital spending, and the authorities are attempting to impose wage and salary restraint. Estimates now put the increase in the Government's wage bill in 1984 at 8 percent, based on the assumption of no general wage and salary increases, compared with increases in the wage bill of 19 percent in 1983 and 22.5 percent in 1982. (Every one percent increase in wages and salaries would add D 6.5 million to the Government's wage bill.) Nevertheless, total expenditure is projected to rise by 21 percent in 1984 (15 percent in 1983). The largest increases in spending are associated with consumer subsidies, mainly for cereal products, which are projected to rise to the equivalent of 4 percent of GNP, and other recurrent transfers to households (including social security payments) and public enterprises. Together, the subsidies and other recurrent transfers would reach 13 percent of GNP. As in the case of revenues, a significant portion (one fifth) of the increase in expenditure is of a nonrecurring nature, i.e., D 90 million of the exceptional profits of the BCT transferred to public enterprises (via a new special consolidation fund) to compensate them for foreign exchange losses in respect of debt service payments. In this regard, the mission noted that, although the public enterprises were to receive this exceptional transfer in 1984, the problem of foreign exchange losses in respect of debt service payments could be a continuing one requiring more fundamental solutions.

To finance the larger overall deficit (D 473 million, compared with D 303 million in 1983), the Government will rely increasingly on both domestic and external sources. Domestically, bank borrowing in 1984 is projected at D 129 million, equivalent to 5.3 percent of end-1983 money plus quasi-money, compared with 2.2 percent in 1983. For external financing, further recourse will be made to the international capital markets (D 68 million, compared with D 50 million in 1983), and cereal credits (D 70 million) will be utilized.

For the medium term, although enhanced revenues are ultimately expected from a tax reform (aimed importantly at increasing the direct tax base by lowering tax rates and at applying value-added taxation on a comprehensive basis) currently being implemented, the mission noted that future growth in revenues will likely be more modest than in the past, as petroleum export-related receipts decline and if, as planned, imports increase less rapidly than GNP. Therefore, the mission suggested that, in addition to stepping up effective implementation of the tax reform, the authorities consider raising the domestic prices of certain petroleum products that remain below international levels. However, in view of the already high revenue burden--35 percent of GNP--the mission stressed that fiscal efforts in the future will have to focus upon containing the growth in expenditures to a rate below that of GNP.

The Tunisian authorities generally shared the mission's assessment but emphasized the political and social constraints on making rapid progress. They stated that the fiscal reform was proceeding as intended, and that effective 1984 the value-added tax on an obligatory basis was being applied to public works and other construction; the transport of merchandise; and certain wholesale activities. Also, income and profit tax rates were reduced by 2 percentage points in respect of 1983 incomes. However, there was a large degree of tax evasion in Tunisia, which the authorities contended would, unless corrected, limit the success of the tax reform. Regarding the mission's suggestion to increase the domestic prices of petroleum products, the Tunisian authorities noted that in principle this course of action, to be effected gradually, had already been adopted, but that implementation could create problems, especially for large industrial users and the poorer segments of the population.

In examining the situation of the public enterprises, the mission pointed to the growing absorption by this sector of Tunisia's financial resources: budgetary financial transfers were equivalent to about 5 percent of GNP, and bank credit to public enterprises accounted for almost one third of credit to the economy. The mission suggested that progress be made in improving the efficiency and financial performance of the public enterprises, including through the adoption of more flexible pricing and employment policies. The Tunisian representatives responded that a commission responsible for examining the restructuring of the public enterprise sector had proposed practical measures and a schedule for their implementation. They concerned norms to be used in deciding how to restrict the number of enterprises that would remain under state control; methods to increase the financial control of enterprises over their affiliates; and measures to improve the operations of enterprises by increasing the responsibility of the heads of the enterprises. A series of laws in these areas was being drafted. Moreover, the development banks were taking a more active role, not only in financing new projects but in restructuring existing enterprises. However, political and social constraints precluded a significant increase in price and employment flexibility.

b. Monetary and credit policies

The mission noted that, continuing the trend of recent years, the projected growth in domestic credit and money plus quasi-money would again exceed by significant margins the projected rise in nominal GNP, putting further pressure on prices and the balance of payments. Therefore, it called for a less accomodative credit policy. Although credit to the economy was projected to increase at a considerably slower rate (14 percent) in 1984 than in 1983 (20 percent), this moderation would stem not so much from deliberate policy changes but mainly from the fact that the public enterprises would receive D 90 million from the special fund for consolidation--an amount that would otherwise be borrowed from the banking system. The mission emphasized once more the apparent need for upward revisions, a simplification, and harmonization in interest rates, not only to help contain credit demand but also to promote financial savings. The mission pointed out that quasi-money as a proportion of GNP had been relatively stable over the past five years, with a decline in enterprise and institutional holdings offset by rising holdings by households. The latter, however, may be attributed more to a shift in the income distribution over the past few years toward wage and salary earners, whose incomes have increased rapidly, rather than to interest rate policy.

The Tunisian authorities did not consider the past growth in credit to the economy excessive and characterized their credit policy as "interventionist," citing favorable treatment accorded requests for agricultural and export credits. Regarding interest rates, they considered the level and structure broadly appropriate. Recently, to attract a larger flow of workers' remittances, the interest rate on convertible dinar accounts was increased from 2 percent to 9 percent. Moreover, new savings schemes were being introduced, including savings/investment plans for certain socio-professional categories to finance their own investment and for other individuals and businesses to finance agreed-upon projects. With respect in lending rates, the authorities did not believe there would be much advantage in raising rates, especially as public enterprises would have to be compensated by increased budgetary transfers.

4. Incomes, prices, and employment policies

The Tunisian authorities recognized the importance of containing wage and salary increases, not only to restrain domestic demand but also to ease cost pressures on Tunisia's productive enterprises, especially exporting firms. For 1984, wage restraint was being pursued, and the Government was currently trying to convince its social partners of the need for wage increases in 1984 to be in line with productivity gains. Although the Government had not factored in any general wage and salary increases in its budget estimates, it was emphasized that, with respect to the current wage negotiations, the objective was not an absolute wage freeze.

Regarding price policy, the Tunisian authorities emphasized that, if their attempt to limit wage increases was to be successful, consumer price rises would have to be moderate, and thus close "supervision" over retail prices would be maintained in 1984. Certain industries were benefiting from a high degree of protection, and in these cases price controls had to be rigorously enforced. For many products, however, there would be only selective supervision. For prices of essential commodities, given the unsustainable subsidy burden, the Government was following a policy of gradual adjustment. Recently, meat prices had been raised; electricity and water tariffs were to be adjusted shortly; and it was anticipated that prices of cereal products would be increased by 10 percent in July.

Tunisia has a high rate of unemployment, and the authorities were conscious of the need to provide increased employment opportunities. This need was made more immediate by the deteriorating prospects for emigrant workers in Europe. Within the revisions made to the 1984 budget, provisions were made to increase employment opportunities through public works programs in both the rural and urban areas. However, it was recognized that substantial and sustainable increases in employment in the medium term would depend primarily on satisfactory expansion in export activities and the agricultural sector, although changing relative factor prices, i.e., lowering labor costs relative to those for capital, could make a contribution.

5. Development planning and sectoral policies

The Tunisian representatives stated that, due to the prolonged drought, a less-favorable-than-anticipated external environment, and slippages in policy implementation, some of the major objectives of the Sixth Development Plan (1982-86) would 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 (1977-81) to an average of 7.1 percent over the 1982-86 period. Current projections showed growth in real GDP of about 4 percent per annum and an average external current account deficit of 8.1 percent of GNP during the Sixth Plan period.

With respect to the level and composition of investment, the Sixth Plan aimed to reduce the investment rate on average to 26 percent of GNP, compared with 30 percent under the Fifth Plan, while changing the sectoral allocation toward labor intensive activities, small- and medium-size enterprises, agriculture, export-oriented industries, and tourism and attempting to promote more balanced regional development. Also, the private sector was to increase its share in total investment. Based on the outturn for 1982-83 and prospects for 1984, the investment rate will still have been 30 percent, somewhat higher than planned, but the sectoral allocation will have approximated the plan's targets, with, as examples, agriculture receiving 14.4 percent of total investment, compared with a target of 15.9 percent; manufacturing obtaining 19.9 percent of investment, compared with a target of 19.2 percent; and tourism accounting for 3.6 percent of investment, compared with a 4.7 percent target. Also, the split between public and private investment in 1982-84, 58 percent and 42 percent, respectively, will have been close to the plan's targets of 56 percent and 44 percent. The Tunisian authorities were aware of the need to curtail the investment level, especially to contain foreign indebtedness, and already there were plans to scale back government direct investment in 1985-86. However, additional resources would be devoted to promoting development in the more backward regions.

In view of the increased emphasis accorded agricultural and manufacturing activities, the mission's discussions on sectoral policies focused on these areas. In the agricultural sector, there had been several recent favorable institutional changes, including the establishment of an agricultural investment code and an investment promotion agency, to promote greater private sector participation, and of the National Bank for Agricultural Development, which had an important role in the expansion of integrated projects. With regard to agricultural pricing policy, to correct for a long-term deterioration in agriculture's terms of trade, in recent years the authorities had been pursuing a policy of steady increases in producer prices of cereals and vegetables. Moreover, to avoid excessive seasonal price fluctuations, price stabilization funds were being established for several commodities. Also, efforts were being made to create adequate networks of storage and input distribution facilities.

The Tunisian authorities said that, in view of the need to restrain overall investment, more selectivity would be required in the choice of new industrial projects, which would take into account the necessities of improving the quality of products and of achieving competitiveness. The authorities would look at Tunisia's structure of imports to understand the production needs of the country better.

IV. Staff Appraisal

As anticipated at the time of the 1983 Article IV consultation, in 1983 there was a rebound in Tunisia's economic activity, with gains in manufacturing output and energy production more than compensating for weather-related stagnation in the agricultural sector and a decrease in tourism. On the other hand, also as envisaged, the domestic financial deterioration that marked 1982 continued, with a widening of the fiscal deficit, another large increase in labor incomes, and further excessive credit and monetary expansion. The adverse effects of these developments on domestic prices and the balance of payments were contained by a tightening of both the price control and the import licensing systems.

For 1984 a further increase in the rate of growth of real GDP, to perhaps 5.5 percent, is likely, especially if agricultural output recovers. But the concerns expressed last year about the need to adopt firmer fiscal, monetary, and incomes policies assumes even more urgency in view of the very limited progress made in these areas over the past year and the projected deterioration in the external current account. Substantial progress needs to be made in implementing adequate adjustment policies if Tunisia is to maintain a viable balance of payments and debt structure and provide an environment conducive to satisfactory economic growth and employment. This will require, in some cases, a substantial departure from present policies, especially concerning demand restraint.

In the fiscal area, for 1984 several revenue measures have been implemented, and a successful effort to curtail the increase in wages and salaries sharply would contribute to moderating expenditure growth. Nevertheless, owing mainly to the growth in subsidies and other current transfers, the overall fiscal deficit is expected to increase by about 2 percentage points in terms of GNP to 7.6 percent, even before any general wage increase is taken into account. The staff notes the attempt made early in the year to eliminate cereal-related subsidies and notes also the political and social constraints that have limited the authorities' room to maneuver in this and other areas of public finance. However, difficult choices will have to be confronted, preferably in 1984 and certainly in 1985 and beyond, and appropriate actions taken to reduce both the fiscal deficit ratio and domestic bank financing. On the revenue side, the tax reform will start to show some positive results only if its pace of implementation is accelerated and the issue of widespread tax evasion is successfully addressed. On the other hand, some more immediate budgetary improvement could be obtained by raising the domestic prices of petroleum products to their international levels. However, the staff notes the already high revenue burden in Tunisia--about 35 percent of GNP--and therefore believes that remedial fiscal actions should focus on expenditures. The staff is in accord with the authorities' recognition that capital outlays will have to be scaled back. But other rapidly rising expenditure components will have to be subject to the same scrutiny, especially the Government's wage bill, consumer subsidy outlays, and transfers to public enterprises. With respect to the last, efforts to improve the enterprises' financial performance have thus far centered on organizational aspects, but more fundamental reorientations are required, especially with respect to pricing and employment.

Regarding monetary and credit policy, the past few years have witnessed a highly accomodative policy, with the money supply increasing by about 19 percent per annum since 1979. For 1984 further rapid increases are foreseen for both domestic credit and the money supply, and the staff believes that substantial restraint is called for. A contribution to restraint could come from raising the level of interest rates, which might also stimulate a needed increase in financial savings. The recent increase in the interest rate on convertible dinar accounts is a move in the right direction.

The authorities are showing a determination to reverse the recent pattern of rapid wage increases, and containment of wage awards to more modest rates would not only moderate domestic demand pressures but would also aid in achieving the authorities' export objectives. At the same time, the authorities should resume their policy of price liberalization in view of the important objectives of increasing economic efficiency and curbing the growth in real domestic demand. Selective measures have been undertaken to promote employment, especially in the agricultural and less developed regions. However, significant and sustained increases in productive employment will depend importantly on the success of policies to promote exports and agricultural production and to reduce the relative factor price of labor.

Regarding investment policy, capital outlays under the Sixth Development Plan have thus far agreed broadly with the plan's target sectoral allocations, with increased emphasis on the agricultural and industrial areas. However, the recognized need for restraint in investment spending calls for the scaling back to be made selectively so as not to hamper unduly future economic development. On the sectoral level the authorities have implemented several institutional reforms in the agricultural area and have paid close attention to the need to provide remunerative producer prices; these policies need to be reinforced.

Medium-term viability for Tunisia's balance of payments will require substantial growth in nonenergy exports. Although Tunisia's export base is already becoming increasingly diversified, success in generating satisfactory export growth will depend importantly on more appropriate supporting policies, especially in the export marketing organization and exchange rate areas. Over the past two years there has been a modest erosion in Tunisia's competitiveness, and the real effective exchange rate has appreciated. Exchange rate policy should therefore be conducted at a minimum, in a manner to prevent further real appreciations. Tunisia's extensive use of import controls is inconsistent with the authorities' objectives to promote exports, encourage foreign investment, improve the overall efficiency of the economy, and moderate inflationary pressures. Therefore, it would be of major benefit to the Tunisian economy if the adoption of an appropriate mix of demand management and supply-oriented policies could enable the authorities to begin to dismantle the extensive system of import controls, including a relaxation of import quotas for consumer goods.

Tunisia continues to maintain restrictions on payments and transfers for current international transactions in the form of limits on the availability of foreign exchange for most invisibles and the requirement of prior authorization for the payment for some imports. As in the case of import restrictions, the staff recommends that the authorities aim at the progressive liberalization of these restrictions. Since the restrictions on payments and transfers for current international transactions are maintained by Tunisia in accordance with Article XIV, they are not subject to Fund approval.

It is noted that the Tunisian authorities have agreed to hold the next Article IV consultation on the standard 12-month cycle.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board :

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Tunisia, in light of the 1984 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.

TUNISIA -- Fund Relations

(As of April 30, 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

Tunisia had a series of stand-by arrangements, the last one of which expired in December 1970. Tunisia's most recent use of Fund resources was in August 1977--a CFF purchase of SDR 24 million.

IV. SDR department

Net cumulative allocation (amount):	34.2
Holdings:	3.3 (9.5 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 March 31, 1984, the dinar rate of the U.S. dollar was D 1 = US$1.4067 equivalent to D 1 = SDR 1.3219.

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	101.3	8.9
Education	65.8	19.4	15.3	19.4
Health	12.5	9.5	1.0	9.5
Energy	112.4	--	60.9	--
Transportation	233.3	16.9	127.0	16.9
Industry and tourism	233.4	10.0	180.3	10.0
Technical assistance	17.9	--	0.3	--
Urban water supply and sewerage	297.0	10.5	136.1	10.5
Total	1,261.9 2/	75.2	622.2	75.2
Repayments	158.9	8.1		
Debt outstanding (including undisbursed)	1,103.0	67.1		
IFC operations (gross commitments)	21.7			

Source: World Bank.

1/ Commitments and disbursements from 1964 through March 1984.
2/ Net of cancellations.

Recent World Bank missions:

February 1983: Industrial Employment Creation (Draft report in May 1984).
October 1983: Hydrocarbon Sector Study (Draft report discussed in April 1984 with the Tunisian Government).
April 1984: Mid-term Plan Review (Draft report in September).
May 1984: Financial Sector Survey (Draft report in September).

TUNISIA - Basic Data

Area, population, and
GDP per capita

Area:	164,154 square kilometers
Population: Total (1983)	6.9 million
Growth rate (1983)	2.5 percent
GDP per capita (1983)	SDR 1,096

	1980	1981	1982	1983 Prelim.	1984 Proj.
	(In millions of dinars)				
Gross domestic product at 1980 prices	3,510	3,709	3,720	3,888	4,102
Agriculture and fishing	490	533	480	483	526
Energy, power, and water	432	419	413	441	438
Mining	45	49	46	56	59
Manufacturing	416	469	481	526	582
Construction and public works	207	237	244	244	241
Services and other	1,446	1,535	1,574	1,635	1,725
Indirect taxes minus subsidies	474	467	482	503	531
Gross national product at current prices	3,532	4,171	4,898	5,520	6,203
Domestic expenditure	3,700	4,487	5,340	5,970	6,703
Private consumption	2,171	2,520	2,979	3,384	3,843
Public consumption	510	622	788	921	1,030
Gross capital formation	1,019	1,345	1,573	1,665	1,830
Resource gap	-168	-316	-442	-450	-500
Increase in consumer prices (percent)	10.0	9.0	13.6	9.0	8.6
Government finance 1/					
Revenue and grants	1,131.2	1,334.6	1,655.7	1,890.1	2,187.6
Current expenditure	-784.1	-909.9	-1,280.2	-1,507.4	-1,891.1
Direct investment	-333.3	-443.5	-515.9	-567.7	-638.8
Capital transfers, participations, and net lending	-112.7	-86.7	-107.8	-118.2	-131.0
Overall deficit (-)	-98.9	-105.5	-248.2	-303.2	-473.3
Financing					
Foreign (net)	80.4	108.7	176.0	74.9	146.4
Domestic (net)	18.5	-3.2	72.2	228.3	326.9
Of which: banking system	(-0.3)	(24.4)	(41.7)	(30.9)	(129.0)

1/ Consolidated operations of the Central Government.

TUNISIA - Basic Data (concluded)

	1980	1981	1982	1983 Prelim.	1984 Proj.
Money and credit (end of period)			(In millions of dinars)		
Foreign assets (net)	191	236	252	389	389
Domestic credit	1,591	1,978	2,440	2,911	3,399
Central Government	(219)	(255)	(307)	(353)	(482)
Economy	(1,372)	(1,723)	(2,133)	(2,558)	(2,917)
Money and quasi-money	1,445	1,724	2,050	2,430	2,871
Money	(950)	(1,115)	(1,379)	(1,652)	(...)
Quasi-money	(495)	(609)	(671)	(778)	(...)
Other items (net)	337	490	642	870	917
Balance of payments			(In millions of SDRs)		
Exports, f.o.b.	1,386	1,789	1,472	1,472	1,540
Imports, f.o.b	-2,213	-2,696	-2,642	-2,578	-2,670
Balance	-827	-907	-1,170	-1,106	-1,130
Net services and transfers	487	493	544	513	480
Current account	-340	-414	-626	-593	-650
Grants	65	17	15	21	20
Direct investment	192	313	365	193	235
Public and private enterprises	121	186	218	299	240
Central Government	67	51	54	87	155
Other 1/	-49	-76	-1	7	--
Capital account	396	491	651	607	650
Allocation of SDRs	7	6	--	--	--
Overall balance	63	83	25	14	--
Outstanding external public debt	2,322	2,654	2,974	3,237	3,680
Debt service ratio	12.1	13.6	14.8	15.7	16.5
Gross official reserves	469	467	556	548	(March) 417
Terms of trade (percentage changes)					
Export prices (in SDRs)	37.6	10.2	-4.4	-6.5	-2.2
Import prices (in SDRs)	17.0	2.3	-1.4	-0.5	-0.2
Terms of trade	14.3	7.8	-2.9	-6.1	-2.1
Exchange rates (period averages)					Q1
D/SDR	0.5270	0.5811	0.6514	0.7249	0.7640
D/F	0.0959	0.0909	0.0900	0.0892	0.0878
D/US$	0.4050	0.4938	0.5907	0.6785	0.7282
Nominal effective exchange rate 2/ (1980 = 100)	100.0	103.0	100.2	100.1	101.0
Real effective exchange rate 2/ (CPI based; 1980 = 100)	100.0	99.1	97.9	97.2	...
Real effective exchange rate 2/ (WPI based; 1980 = 100)	100.0	99.9	107.9	107.1	...

1/ Including short-term capital, commercial banks, and errors and omissions.
2/ Weighted by total trade (excluding petroleum) plus tourism.