

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

EBS/88/119
Correction 1

CONFIDENTIAL

July 28, 1988

To: Members of the Executive Board
From: The Acting Secretary
Subject: Tunisia - Request for Extended Arrangement

The following corrections have been made in EBS/88/119
(6/20/88):

Page 3, Table 2, last column,
third purchase, lines 2 and 3: for "end-March 1988" read "end-March 1989"

fourth purchase, lines 2 and 3: for "end-June 1988" read "end-June 1989"

Page 5, 1st full para., line 4: for an "18-month" read "a 19-month"

Page 34, Table 11, columns 5 and 6, line 10: for "2,109 3,066"
read "-2,109 -3,066"

Page 60, item VII, Total, columns 3-6: for "18.25, 15.85, 14.84, 13.79"
read "100.23, 114.95, 35.72, 25.52"

Corrected pages are attached.

Att: (4)

Table 2. Tunisia: Schedule of Purchases During Period of Extended Arrangement, July 1988-July 1991

Amount (in millions of SDRs)	Scheduled availability date	Conditions necessary for purchase
15.95	July 15, 1988	Board approval of program.
15.95	November 15, 1988	Compliance with quantitative performance criteria as of September 30, 1988.
15.95	March 15, 1989	Compliance with quantitative performance criteria as of end-December 1988 and completion of first review (elaboration of program for 1989).
15.95	May 15, 1989	Compliance with quantitative performance criteria as of end-March 1989.
15.95	August 15, 1989	Compliance with quantitative performance criteria as of end-June 1989. Completion of second review (midterm review 1989).
15.95	November 15, 1989	Compliance with quantitative performance criteria as of end-September 1989.
15.95	March 15, 1990	Compliance with quantitative performance criteria as of end-December 1989 and completion of third review (elaboration of program for 1990).
15.95	May 15, 1990	Compliance with quantitative performance criteria as of end-March 1990.
15.95	August 15, 1990	Compliance with quantitative performance criteria as of end-June 1990 and completion of fourth review (midterm review 1990).
15.95	November 15, 1990	Compliance with quantitative performance criteria as of end-September 1990.
15.95	March 15, 1991	Compliance with quantitative performance criteria as of end-December 1990 and completion of fifth review (elaboration of program for 1991).
15.95	May 15, 1991	Compliance with quantitative performance criteria as of end-March 1991.
15.90	July 10, 1991	Compliance with quantitative performance criteria as of end-May 1991.

July 15, 1991. A waiver of the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement will be required, and is proposed.

World Bank lending to Tunisia is substantial, and the Fund and the Bank have collaborated closely on policy recommendations. The World Bank has extended two policy-based sector loans; in addition, a structural adjustment loan for \$150 million is scheduled to be considered by the Bank's Executive Board in mid-June, and a public enterprise restructuring loan is likely to be negotiated before the end of 1988.

The proposed extended arrangement is described in Appendix I. Summaries of Tunisia's relations with the Fund and the World Bank are provided in Appendices II and III, respectively; Appendix IV contains a summary of the proposed program; and Appendix V contains selected social indicators.

II. Recent Developments and Policies

1. Background

Tunisia is a medium-sized middle-income country, with a population of 7.5 million and a per capita income of SDR 1,018 (1986). Arid or semi-arid, its most important raw materials are petroleum, natural gas, and phosphates. Exploitation of the moderate petroleum and natural gas reserves (presently accounting for some 25 percent of exports) has helped finance a relatively rapid development of the economic and human infrastructure and a significant diversification of the economy. The agricultural sector, which is vulnerable to severe fluctuations in annual rainfall, still employs about one third of the labor force. The projected depletion of hydrocarbon resources and increasing domestic consumption is expected to turn Tunisia into a net oil importer by 1991. Further development of the phosphates and phosphate processing industry (accounting for some 20 percent of exports) is constrained by the low quality of deposits. The country has a sizable tourism sector.

Tunisia averaged high real rates of economic growth in the 1970s and the first half of the 1980s. However, the growth performance toward the end of this period was accompanied by a marked deterioration in the domestic and external financial situation as domestic savings declined in relation to GDP while investment was maintained at a relatively high level. In spite of efforts to reduce the fiscal imbalances, the fiscal policy stance remained relatively expansionary, and monetary policy was highly accommodating. Reflecting resource gaps averaging 8.5 percent of GDP over the 1983-85 period, external debt rose rapidly to the equivalent of 48.7 percent of GDP at end-1985, the debt service ratio increased to 21.6 percent, and the once relatively comfortable level of foreign exchange reserves was eroded. The pressures induced by the resource imbalance led the Tunisian authorities to increase their

reliance on price controls and to further tighten investment controls and import restrictions.

Against this background, and as the sharp drop in oil prices in early 1986 put the economy under increased financial pressure, the authorities in mid-1986 elaborated an economic and financial program, which was supported by a 19-month stand-by arrangement from the Fund, aimed at halting the deterioration in 1986 and laying the foundation for a sustained improvement in 1987 and the medium term. The program called for the adoption of tight demand-management policies and a significant improvement in the competitiveness of the economy. At the same time, the program also included a comprehensive set of structural adjustment measures, focusing on the reorientation of economic policies away from the heavy reliance on administrative controls and public sector involvement toward an increased role for market signals and the private sector.

2. Performance under the stand-by arrangement, 1986-87

As indicated in the staff reports on the three reviews under the arrangement, 1/ the economic and financial performance under the program was good. Following a stagnation in 1986 induced by a severe drought and the deterioration in the terms of trade, the Tunisian economy showed a remarkable recovery in 1987. Led by a strong performance of agriculture, tourism, and increasing exports, real GDP growth reached 5.8 percent in 1987, compared with the target of 5.0 percent (Table 3). 2/ After having been limited to about 8 percent of GDP in 1986, the current account deficit of the balance of payments was reduced sharply to 1.4 percent in 1987 (compared with the target of 5.8 percent), resulting about equally from a drop in the investment to GDP ratio and an increase in the savings ratio. The improvement in the central government consolidated deficit was greater than programmed, with the deficits in 1986 and 1987 being limited to 5.7 percent and 3.6 percent of GDP, respectively. Reflecting the ongoing liberalization and adjustments to administered prices, the general consumer price index rose by 5.8 percent in 1986 and by 8.2 percent in 1987, compared with the target of 8 percent. After limiting the loss to slightly less than programmed in 1986, the authorities were able to achieve a significant buildup in gross foreign reserves in 1987, given the much-lower-than expected current account deficit. Consistent with the reduced need for balance of payments financing, the debt to GDP ratio at end-1987 was limited to 57.8 percent, as against a program projection of 60.8 percent.

While the overall economic and financial situation thus improved significantly during the program period, reflecting in part the quick response of exports of goods and services to the adjustment measures, activity in those sectors geared toward the domestic market was affected by the larger-than-projected decline in domestic demand, as investment

1/ Most recently in EBS/88/57, March 10, 1988.

2/ Targets for 1987 are established in EBS/87/200.

Table 3. Tunisia: Selected Economic and Financial Indicators, 1986-91

	1986	1987	1988	1989	1990	1991
		Program (ERS/87/200)	Actual	Projections		
(Annual percent changes)						
National income and prices						
GDP at constant prices	-1.6	5.0	5.8	0.9	5.1	4.3
GDP deflator	3.3	7.5	7.5	4.9	6.5	6.0
Consumer price index (CPI)	5.8	8.0	8.2	6.5	6.5	6.1
External sector (In SDRs)						
Exports, f.o.b.	-11.5	5.4	9.7	1.1	6.8	8.2
Imports, f.o.b.	-7.6	-1.8	-5.5	10.2	5.2	7.0
Terms of trade (deterioration -)	-11.7	1.4	3.1	-3.0	-0.4	0.5
Nominal effective exchange rate (depreciation -) <u>1/</u>	-23.0 <u>2/</u>	...	-5.5	...	...	...
Real effective exchange rate CPI-based (depreciation -) <u>1/</u>	-21.5 <u>2/</u>	...	-4.7	...	...	...
Central government consolidated operations						
Revenue and grants	-0.9	5.5	4.9	6.6	6.0	7.7
Total expenditure and net lending	2.3	2.6	2.4	8.1	4.8	5.9
Current expenditure	0.8	7.1	4.4	9.2	4.0	6.9
Capital expenditure and net lending	5.9	-7.5	-9.1	5.5	7.2	3.3
Money and credit						
Domestic credit	8.3	10.6	7.9	8.7	...	...
Government	(13.2)	(13.8)	(14.9)	(6.9)	(...)	(...)
Economy	(7.5)	(10.0)	(6.7)	(9.0)	(...)	(...)
Money plus quasi-money	5.7	13.1	13.7	9.0	...	...
Interest rates						
Money market rates	10.25	10.00	9.50	...	...	...
12- to 18-month time deposit	8.00	9.00 <u>3/</u>	8.50 <u>3/</u>	...	...	...
General short-term advances	11.50	13.00 <u>4/</u>	12.50 <u>4/</u>	...	...	...
(Ratios: in percent of GDP, unless otherwise specified)						
Government revenue and grants	34.6	32.2	31.9	32.1	30.5	29.7
Total expenditure and net lending	40.3	36.4	35.5	36.3	34.0	32.6
Current expenditure	27.8	26.3	25.5	26.4	24.5	23.7
Capital expenditure and net lending	12.4	10.1	9.9	9.9	9.5	8.9
Central government consolidated deficit (commitment basis) (-)	-5.7	-4.2	-3.6	-4.1	-3.5	-2.9
Domestic bank financing	(1.0)	(1.1)	(1.2)	(0.6)	(...)	(...)
Gross fixed capital formation	23.8	21.5	20.4	21.3	21.7	22.2
Public <u>5/</u>	13.3	...	11.5	11.1	10.7	9.9
Private	10.5	...	8.9	10.2	11.0	12.3
Gross national savings	15.5	16.3	19.8	17.4	19.2	20.5
External current account deficit (-)	-8.0	-5.8	-1.4	-3.8	-3.4	-2.8
External public debt	56.1	60.8	57.8	60.6	59.5	56.8
Debt service/Exports of goods and services plus private transfers	27.9	27.0	26.2	26.4	26.2	28.9
Gross official international reserves (in months of imports, f.o.b.)	1.3	1.8	2.0	2.5	3.0	2.9
(In millions of SDRs)						
Overall balance of payments surplus or deficit (-)	-190	95	117	77	75	52
Gross official international reserves (at end of period)	256	339	393	531	660	685
External debt <u>6/</u>	4,229	4,768	4,315	4,615	4,906	5,034
(In millions of dinars)						
GDP at current prices	7,026	7,965	7,993	8,455	9,457	10,456

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

^{1/} Weighted by non-oil trade and tourism flows of 17 partner and competitor countries.

^{2/} From December 1985 to December 1986.

^{3/} Freely determined by banks.

^{4/} Freely determined by banks subject to a cap of 3 percent over the money market rate.

^{5/} Including local government and public enterprises.

^{6/} Including to the IMF.

68 percent (both with 1987 weights). The second stage of the import tariff reform came into effect in January 1988, entailing reductions in the range of 1-9 percentage points, with a maximum tariff set at 43 percent and a minimum at 17 percent. In addition, in order to encourage private investment, most capital goods imports are now subject to the minimum rate.

In January 1988, the authorities further liberalized producer prices for various manufactured goods, thereby raising the share of goods for which prices have been liberalized since 1986 to about 55 percent of manufacturing production. An additional list of prices is to be liberalized in July 1988, bringing this proportion to approximately 60 percent. Furthermore, the authorities are initiating the liberalization of distribution margins by freeing, in July 1988, the margins for products representing at least 10 percent of manufacturing production.

A number of increases in controlled prices (notably petroleum products and prices subsidized by the Caisse Générale de Compensation) and public tariffs have already been implemented in line with the objective of mobilizing resources for the government and public agencies as well as limiting the deficit of the Caisse to its 1987 level.

5. Performance criteria, indicative targets, reviews, and phasing of purchases

The proposed extended arrangement includes the following performance criteria: (a) a ceiling on net domestic credit by the banking system; (b) a subceiling on net credit to the Government by the banking system; (c) a minimum level of net foreign assets of the Central Bank, starting from December 1988; (d) limits on external nonconcessional debt contracted or guaranteed by the Government with a maturity of less than 1 year, between 1 year and 5 years, and between 1 year and 12 years; no accumulation of external payments arrears; and (f) the standard clauses regarding the exchange and payments system. In addition, the program includes the following indicative targets: (a) consolidated deficit of the Central Government; (b) central government revenue and grants; (c) central government expenditures and net lending; (d) credit to selected public enterprises from the banking system and from the development banks; and (e) total credit extended by the development banks. As shown in Table 11, performance criteria and indicative targets have been established for end-June, end-September, and end-December. The performance criteria and indicative targets for the remainder of the program period will be established in the context of the reviews under the program.

Five reviews are envisaged in the program, to be completed before March 15, 1989; August 15, 1989; March 15, 1990; August 15, 1990; and March 15, 1991. The completion of each of these reviews will be necessary for making further purchases from the Fund. The first, third, and fifth reviews will establish annual financial programs for the years 1989, 1990, and 1991, respectively, including the determination of

Table 11. Tunisia: Performance Criteria and Indicative Targets,
December 1987-December 1988

	1987	1988				
	Dec. Performance	Mar. 1/ Act.	Prog.	June 2/ Prog.	Sept. Prog.	Dec. Prog.
A. Performance criteria						
		(In millions of dinars)				
1. Domestic credit	4,600	4,551	4,692	4,796	4,872	4,999
2. Net credit to the Government	721	697	721	760	737	771
		(In millions of SDRs)				
3. Net foreign assets of the Central Bank	145	55	27 <u>3/</u>	64 <u>3/</u>	192 <u>3/</u>	220
4. Official borrowing abroad <u>4/</u>						
a. 0-1 year (amount outstanding, excluding import-related credits)	14	11	120	120	120	120
b. New nonconcessional borrowing abroad (cumulative amounts since January 1, 1988)						
(i) 1-5 years	57	98	170	170	170	170
(ii) 1-12 years	136	186	450	450	450	450
5. External payments arrears (amount outstanding)	—	—	—	—	—	—
B. Indicative targets						
		(In millions of dinars)				
1. Consolidated central government deficit-287	...	...	-47	-199	-206	-350
2. Total revenue and grants	2,549	...	605	1,252	1,903	2,716
3. Total expenditure and lending (excluding debt amortization)	-2,836	...	-652	-1,451	-2,109	-3,066
4. Credit by monetary system to selected public enterprises <u>5/</u>	...	...	...	...	...	...
5. Credit by development banks <u>5/</u>						
a. to selected public enterprises	...	...	...	...	...	...
b. to the rest of the economy	...	...	...	...	...	...

1/ Performance criteria under the stand-by arrangement (EBS/88/57).

2/ Indicative targets.

3/ Indicative targets; the end-March figure corresponds to a target of SDR 42 million for the monetary system as a whole, as included in the stand-by arrangement.

4/ Contracted or guaranteed by the Government or Central Bank.

5/ A procedure for monitoring these aggregates is being established; information will be sent monthly to the Fund from the beginning of the program, and indicative targets for 1989 will be established during the first review of the program.

TUNISIA--Relations with the Fund

(As of April 30, 1988)

I. Membership status

Date of membership:
Status:

April 14, 1958
Article XIV

A. Financial Relations

II. General Department (General Resources Account)

- (a) Quota: SDR 138.2 million
- (b) Total Fund holdings of Tunisia's
currency: SDR 343.93 million (248.86 percent of quota)

	<u>Millions of SDRs</u>	<u>Percent of quota</u>
(c) Fund credit:	205.71	148.84
Credit tranches	91.00	65.84
CFF	114.71	83.00

- (d) Reserve tranche position: Nil

III. Stand-by arrangement or special facilities

(a) Stand-by arrangement

- (i) Duration: November 4, 1986-May 31, 1988
- (ii) Amount: SDR 103.65 million (75.0 percent of quota)
- (iii) Utilization: SDR 91.0 million

(b) Compensatory financing facility

- (i) Date: November 4, 1986
- (ii) Amount: SDR 114.71 million (83 percent of quota)

IV. SDR Department

- (a) Net cumulative allocation (amount): SDR 34.24 million
- (b) Holdings: SDR 34.84 million (101.73 percent of allocation)

V. Administered accounts

Not applicable

VI. Overdue obligations to the Fund

None

TUNISIA - Relations with the Fund (concluded)VII. Principal and Interest due to the Fund 1/ (in millions of SDRs)

	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Repurchase obligations	--	--	81.98	99.10	20.88	11.73
Charges and interest	12.85	16.11	18.25	15.85	14.84	13.79
Total	12.85	16.11	100.23	114.95	35.72	25.52

1/ Assuming purchases are made as scheduled under the arrangement.

B. Nonfinancial Relations

VIII. Exchange system: The exchange rate of the Tunisian dinar is determined flexibly vis-à-vis a basket of currencies under a system of managed floating. Buying and selling rates are determined daily by the Central Bank. As of end-April 1988, the dinar rate of the U.S. dollar was US\$1 = D 0.8180, equivalent to SDR 1 = D 0.8832.

IX. Last Article IV consultation

The 1987 Article IV consultation discussions were held in Tunis during July 22-August 4, 1987, and the staff report (EBS/87/200) and the report on recent economic developments (SM/87/239) were discussed by the Executive Board on October 16, 1987. The decision adopted was as follows:

1. The Fund takes this decision in concluding the 1987 Article XIV consultation with Tunisia, in the light of the 1987 Article IV consultation with Tunisia conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The restrictions on the making of payments and transfers for current international transactions, described in EBS/87/200, are maintained by Tunisia in accordance with Article XIV. The Fund is encouraged by the steps already taken to ease these restrictions and urges an early and vigorous implementation of the intention of further liberalization in this area.