DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBS/88/119

CONFIDENTIAL

June 20, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Tunisia - Request for Extended Arrangement

Attached for consideration by the Executive Directors is a request from Tunisia for an arrangement under the extended Fund facility equivalent to SDR 207.3 million, which will be brought to the agenda for discussion on a date to be announced. A draft decision appears on page 38.

Mr. Bornemann (ext. 6962), Mr. Anjaria (ext. 8357), or Mr. Petersen (ext. 8390) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

TUNISIA

Request for Extended Arrangement

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 H.B. Junz

June 17, 1988

I. Introduction

In the attached letter dated June 16, 1988, to which is annexed a memorandum on the economic and financial policies of Tunisia during the period 1988-91, the Government of Tunisia requests a three-year extended arrangement in an amount equivalent to SDR 207.3 million (150 percent of quota, or 50 percent on an annual basis). Discussions on the proposed arrangement were held in Tunis during the period April 7-20, 1988, and at headquarters during the period May 6-13, 1988. 1/ The arrangement is requested in support of the Government's medium-term adjustment program formulated in the context of the Seventh Development Plan ending in 1991.

Tunisia made the first six purchases, totaling the equivalent of SDR 91 million, out of the seven foreseen in the stand-by arrangement that expired on May 31, 1988. The last purchase, which was dependent on performance criteria for end-March 1988 was not made, although all the performance criteria at end-March were observed, as the authorities considered the level of gross reserves to be relatively adequate at the time.

As of end-May 1988, the Fund's holdings of Tunisian dinars subject to repurchase were equivalent to SDR 205.71 million or 148.80 percent of quota (Table 1). If the full amount available under the requested extended arrangement is purchased according to the proposed schedule (Table 2), and after taking into account scheduled repurchases, the Fund's holdings of Tunisian dinars subject to repurchase would amount to the equivalent of SDR 281.46 million or 203.66 percent of quota by

---

1/ The staff members who took part in the discussions in Tunis were Messrs. Bornemann (head), Petersen, and Khallouf (all AFR), Tazi (FAD), and Parcu (ETR), and Mrs. Klotz (secretary-PAR). In addition, Mr. Anjaria (AFR) participated in the discussions at headquarters.

Table 1. Tunisia: Fund Position During Period of the Extended Arrangement, 1988-91

	Outstanding May 31, 1988	1988 July-Sept.	1988 Oct.-Dec.	1989 Jan.-March	1989 Apr.-June	1989 July-Sept.	1989 Oct.-Dec.	1990 Jan.-March	1990 Apr.-June	1990 July-Sept.	1990 Oct.-Dec.	1991 Jan.-March	1991 Apr.-June	1991 July 1-July 15
						(In millions of SDRs)								
Transactions under tranche policies	...	15.95	15.95	15.95	15.95	15.95	15.95	11.57	10.45	9.20	7.95	6.45	6.45	14.02
Purchases	...	15.95	15.95	15.95	15.95	15.95	15.95	15.95	15.95	15.95	15.95	15.95	15.95	15.90
Ordinary resources	(...)	(15.95)	(15.95)	(15.95)	(15.95)	(15.95)	(15.95)	(15.95)	(15.95)	(9.43)	(—)	(—)	(—)	(—)
Borrowed resources	(...)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(6.52)	(15.95)	(15.95)	(15.95)	(15.90)
Repurchases	...	—	—	—	—	—	—	4.38	5.50	6.75	8.00	9.50	9.50	1.88
Ordinary resources	(...)	(—)	(—)	(—)	(—)	(—)	(—)	(4.38)	(5.50)	(6.75)	(8.00)	(9.50)	(9.50)	(1.88)
Borrowed resources	(...)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)
Transactions under special facilities (net)	...	—	—	—	—	—	—	-14.34	-14.34	-14.34	-14.34	-14.34	-14.34	—
Purchases	(...)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)
Repurchases	(...)	(—)	(—)	(—)	(—)	(—)	(—)	(14.34)	(14.34)	(14.34)	(14.34)	(14.34)	(14.34)	(—)
Total Fund credit outstanding (end of period)	205.71	221.66	237.61	253.56	269.51	285.46	301.41	298.64	294.75	289.61	283.22	275.33	267.44	281.46
Under credit tranche policies	91.00	106.95	122.90	138.85	154.80	170.75	186.70	198.27	208.72	217.92	225.87	232.32	238.77	252.79
Special facilities	114.71	114.71	114.71	114.71	114.71	114.71	114.71	100.37	86.03	71.69	57.35	43.01	28.67	28.67
						(As percent of quota)								
Total Fund credit outstanding (end of period)	148.80	160.39	171.93	183.47	195.01	206.56	218.10	216.09	213.28	209.56	204.94	199.23	193.52	203.66
Under credit tranche policies	65.80	77.39	88.93	100.47	112.01	123.55	135.09	143.47	151.03	157.69	163.44	168.10	172.77	182.92
Special facilities	83.00	83.00	83.00	83.00	83.00	83.00	83.00	72.63	62.25	51.87	41.50	31.12	20.75	20.74

Source: IMF, Treasurer's Department.

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 1988.
15.95	August 15, 1989	Compliance with quantitative performance criteria as of end-June 1988. 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

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 1988.
15.95	August 15, 1989	Compliance with quantitative performance criteria as of end-June 1988. 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 an 18-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 Program (EBS/87/200)	1987 Actual	1988	1989	1990	1991
				Projections			
			(Annual percent changes)				
National income and prices							
GDP at constant prices	-1.6	5.0	5.8	0.9	5.1	4.3	3.7
GDP deflator	3.3	7.5	7.5	4.9	6.5	6.0	5.7
Consumer price index (CPI)	5.8	8.0	8.2	6.5	6.5	6.1	5.2
External sector (in SDRs)							
Exports, f.o.b.	-11.5	5.4	9.7	1.1	6.8	8.2	6.6
Imports, f.o.b.	-7.6	-1.8	-5.5	10.2	5.2	7.0	6.1
Terms of trade (deterioration -)	-11.7	1.4	3.1	-3.0	-0.4	0.5	-0.1
Nominal effective exchange rate (depreciation -) 1/	-23.0 2/	...	-5.5	...	...	...	...
Real effective exchange rate CPI-based (depreciation -) 1/	-21.5 2/	...	-4.7	...	...	...	...
Central government consolidated operations							
Revenue and grants	-0.9	5.5	4.9	6.6	6.0	7.7	7.9
Total expenditure and net lending	2.3	2.6	2.4	8.1	4.8	5.9	6.1
Current expenditure	0.8	7.1	4.4	9.2	4.0	6.9	5.7
Capital expenditure and net lending	5.9	-7.5	-9.1	5.5	7.2	3.3	7.3
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 3/	8.50 3/	...	...	...	...
General short-term advances	11.50	13.00 4/	12.50 4/	...	...	...	...
			(Ratios: in percent of GDP, unless otherwise specified)				
Government revenue and grants	34.6	32.2	31.9	32.1	30.5	29.7	29.2
Total expenditure and net lending	40.3	36.4	35.5	36.3	34.0	32.6	31.5
Current expenditure	27.8	26.3	25.5	26.4	24.5	23.7	22.8
Capital expenditure and net lending	12.4	10.1	9.9	9.9	9.5	8.9	8.7
Central government consolidated deficit (commitment basis) (-)	-5.7	-4.2	-3.6	-4.1	-3.5	-2.9	-2.3
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	22.8
Public 5/	13.3	...	11.5	11.1	10.7	9.9	9.6
Private	10.5	...	8.9	10.2	11.0	12.3	13.2
Gross national savings	15.5	16.3	19.8	17.4	19.2	20.5	21.4
External current account deficit (-)	-8.0	-5.8	-1.4	-3.8	-3.4	-2.8	-2.3
External public debt	56.1	60.8	57.8	60.6	59.5	56.8	53.7
Debt service/Exports of goods and services plus private transfers	27.9	27.0	26.2	26.4	26.2	28.9	27.2
Gross official international reserves (in months of imports, f.o.b.)	1.3	1.8	2.0	2.5	3.0	2.9	2.7
			(In millions of SDRs)				
Overall balance of payments surplus or deficit (-)	-190	95	117	77	75	52	50
Gross official international reserves (at end of period)	256	339	393	531	660	685	663
External debt 6/	4,229	4,768	4,315	4,615	4,906	5,034	5,081
			(In millions of dinars)				
GDP at current prices	7,026	7,965	7,993	8,455	9,457	10,456	11,466

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 goverment and public enterprises.
6/ Including to the IMF.

fell by 29 percent in real terms between 1985 and 1987, and private consumption stagnated. This was the result not only of the strict demand-management policies pursued, and the measures adopted to increase financial savings, but also of a cautious response of the private sector to the change in policy direction, perhaps reflecting in part political uncertainties prior to the change in leadership in November 1987. The lower-than-programmed level of investment had a negative impact on the rate of employment creation, thus aggravating the rate of unemployment, currently estimated at 15 percent.

The implementation of structural policy measures proceeded largely on schedule during the program period. After a depreciation of 21.5 percent in real effective terms during 1986, the dinar was depreciated by a further 4.5 percent in 1987 (Chart 1). The first stage of the customs tariff reform was introduced in January 1987, and imports of a wide range of raw materials, spare parts, and semifinished products were liberalized in February 1987. Prices of manufactured products were liberalized in three steps, taking the ratio of goods for which producers can freely set prices to 45 percent of manufactured production. A significantly liberalized investment code was enacted in August 1987. Finally, most interest rates were liberalized in January 1987. 1/ In addition to the measures foreseen under the program, toward the end of 1987 the authorities introduced a package of measures aimed at encouraging private investment and at compensating part of the erosion in real wages. These included a 60 percent reduction in the service tax (TPS) on interest charges, which in effect reduced interest rates by 1.2 percentage points; a tax amnesty, including fiscal incentives for investment in priority sectors; and a 5 percent increase in legal minimum wages.

Fiscal policy was somewhat tighter than programmed. The consolidated central government deficit in 1986 (on a commitment basis) amounted to 5.7 percent of GDP (compared with the program target of 6.0 percent), and was further reduced to 3.6 percent in 1987 (compared with the program target of 4.2 percent). Central government revenues, increasing on average by 2.0 percent per year, fell somewhat short of program projections in both years (by an average of 0.3 percent of GDP), partly reflecting the depressed levels of domestic demand and partly the lower oil revenues. 2/ In relation to GDP, revenues declined from 35.8 percent in 1985 to 31.9 percent in 1987. Total expenditures and net lending, growing on average by 1.3 percent, were kept well below planned levels, which more than offset the revenue shortfall. Government outlays for goods and services and interest payments were lower than budgeted in both years, helped by lower consumer subsidies in

---

1/ Lending rates, however, remained subject to a cap of 3 percent over the money market rate.

2/ Revenues were adversely affected by the decline in oil prices in 1986 and by the combined effect of lower imports and import duty reforms. Adjusting for these factors, the average growth of revenues amounted to 5.5 percent.

1986 and by a cut in capital expenditures and net lending in 1987. In relation to GDP, expenditures declined from 40.4 percent in 1985 to 35.5 percent in 1987.

The financing of the deficits differed significantly from the one foreseen in the program. While in 1986 both foreign and domestic financing was somewhat lower than expected, net foreign financing in 1987 fell significantly short of projections (by D 106 million), mainly on account of lower external program lending. The shortfall was largely offset by lower expenditures and by higher nonbank domestic financing.

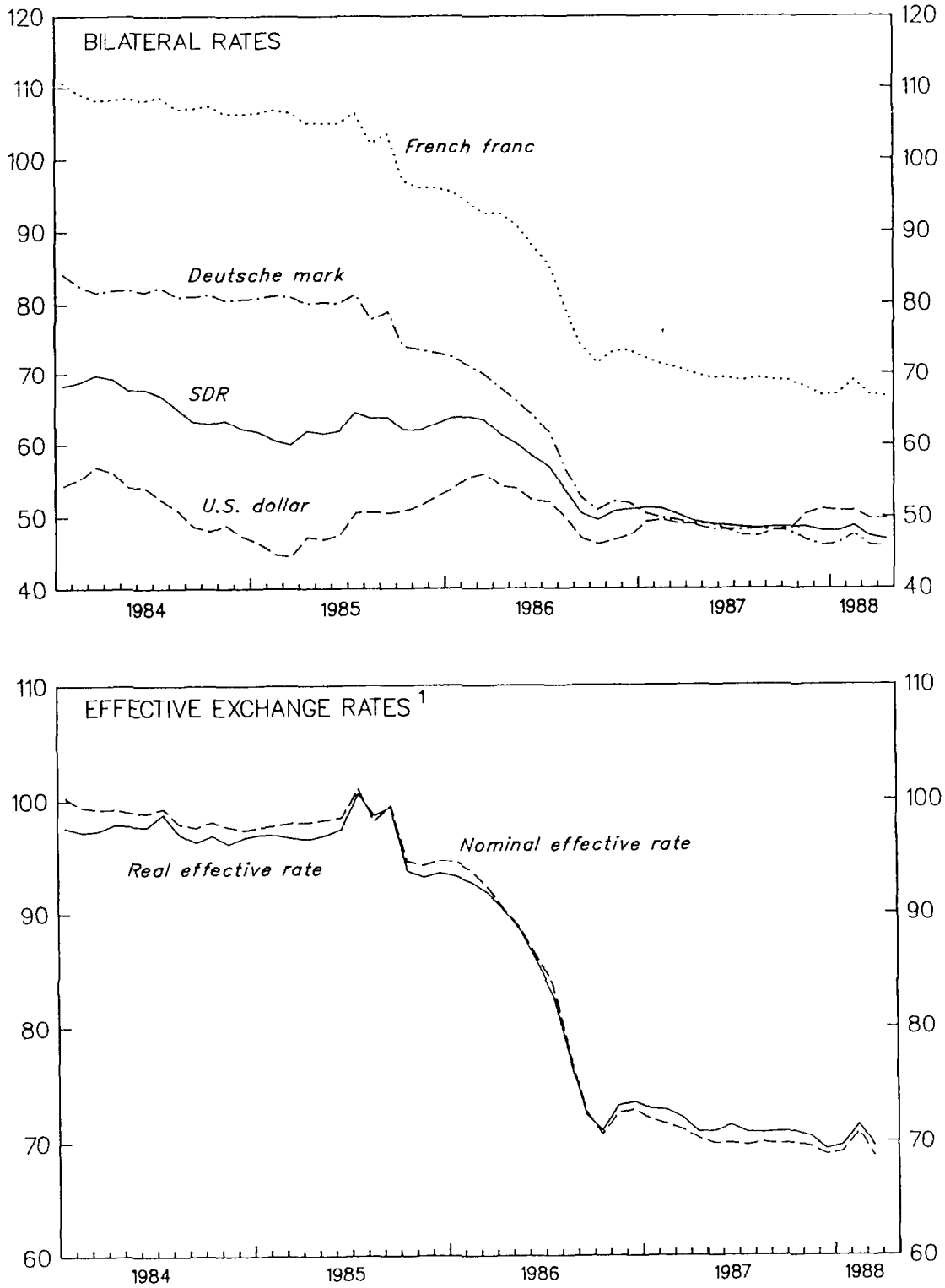
Monetary developments were broadly in line with the program. Domestic credit expansion was reduced from 17 percent in 1985 to 8.3 percent in 1986, and to 7.9 percent in 1987. While credit to the Government was close to the program limit, credit expansion to the rest of the economy was much less than programmed, reflecting the weakness of domestic demand. In line with program objectives and corresponding to the increase in net foreign assets of the banking system, the rate of increase of broad money accelerated from 5.7 percent in 1986 to 13.7 percent in 1987, slightly exceeding the growth in nominal GDP.

The external payments position remained under heavy pressure in 1986. However, the outcome--a current account deficit equivalent to 8.0 percent of GDP, and an overall deficit equivalent to SDR 190 million--was somewhat better than programmed as exports and workers' remittances reacted quickly to the devaluation of the exchange rate and imports were lower than expected.

In 1987, the current account improved sharply, registering a deficit of only SDR 103 million (1.4 percent of GDP compared with the revised program target of 5.8 percent). In addition to the stronger-than-expected impact of the exchange rate action, favorable exogenous factors, including the excellent agricultural crop and a rebound of oil prices, contributed to the better-than-programmed performance. The increase in non-oil export volumes exceeded 13 percent, with most export sectors showing strong growth. The tourist sector showed exceptionally favorable results, registering an increase of 40 percent at constant prices. Imports declined by 4.1 percent in volume terms, in part because of the renewed competitiveness of the Tunisian economy, as well as the sharply reduced need for imported food. To a significant extent the decline also stemmed from the lower-than-expected level of investment that led to a sharp drop in imports of capital goods (30 percent in volume terms).

The sharp decline in the current account deficit more than compensated for the fact that capital inflows were much lower than expected. The shortfalls partly reflected the low level of capital goods imports and consequently of its linked financing, but also stemmed from lower-than-programmed drawings from available untied credit lines. Overall, net official external reserves increased by SDR 117 million, compared with the targeted level of SDR 95 million.

CHART 1
TUNISIA
INDICES OF SELECTED EXCHANGE RATES,
JANUARY 1984–APRIL 1988
(1980=100; foreign currency per Tunisian dinar)



Source: IMF, Economic Information System.
[1]Weighted by total trade (excluding petrolium) plus tourism with 17 trading partners.

The debt service ratio at 26.2 percent was slightly better than programmed, and the debt to GDP ratio at 57.8 percent was 3 percentage points lower than programmed because of the lower level of net external borrowing.

III. Macroeconomic Framework and Policy Objectives for 1988-91

1. Macroeconomic framework

The authorities consider the good results obtained in 1987 a clear demonstration that the policies being undertaken in the context of their Seventh Development Plan are well suited to bring about growth through structural adjustment. Hence, their medium-term economic and financial program builds on the progress achieved in 1986-87 under the stand-by arrangement and aims at maintaining the momentum in the structural adjustment and liberalization of the economy. The program to be supported by the extended arrangement is directed at achieving both sustained growth and balance of payments viability. The authorities' strategy will continue to focus on shifting resources toward the tradable goods sector (particularly nontraditional exports and tourism), through the promotion of private sector initiative, cautious fiscal policies, and more efficient management of the public enterprise sector.

As financial imbalances were significantly reduced during the recently expired stand-by arrangement, the authorities are in a better position to shift the emphasis of the program toward completing the liberalization of the economy and the redeployment of the productive system. Given the time required to build a large and efficient tradable goods sector that could generate additional resources and employment opportunities, the structural shift toward growth led by external demand requires careful management of domestic demand. With the drop in the real purchasing power of households in recent years and the worrisome unemployment situation, the authorities are concerned that an unduly deflationary policy stance could trigger recession in certain sectors oriented toward the domestic market before their strategy of export-led growth fully bears fruit. Nevertheless, the authorities accept that a relative decline in activity and investment in domestically oriented sectors is unavoidable to release resources in favor of the tradeable goods sector. Therefore, during the program period, the authorities intend to pursue a sustained fiscal adjustment, which should make it possible to finance the significant investment effort required for restructuring the productive system without putting undue pressure on the balance of payments.

Consistent with these policy orientations, the macroeconomic objectives of the program include a gradual but steady reduction in financial imbalances and, in particular, a consolidation of balance of payments viability by the turn of the decade. Following the exceptionally favorable performance in 1987, the progress in reducing financial imbalances and promoting growth is to be assessed against the

largely exogenous deterioration in 1988 owing to a severe drought and an invasion by locusts. This will have a significant negative impact on the growth of the economy in 1988, currently estimated at the equivalent of more than 2 percentage points of GDP, and on the balance of payments. Though transitory, these factors will have carry-over effects in 1989-90 through the damage inflicted to olive and fruit trees and to the livestock sectors.

The objectives for the program period (1988-1991) are:

(i) to achieve an average annual growth of GDP of at least 3.5 percent in real terms;

(ii) to reduce domestic price inflation (measured by the average annual increase in the general consumer price index) from 8.2 percent in 1987 to some 5 percent by 1991 and to the average level projected for Tunisia's trading partners thereafter;

(iii) to reduce the consolidated deficit of the Central Government (on a commitment basis) to 2.3 percent of GDP by 1991, despite the expected significant drop in oil revenues;

(iv) to reduce the external current account deficit (excluding grants) to 2.3 percent of GDP by 1991 after a deterioration to 3.8 percent in 1988, notwithstanding the investment effort required in the coming years and the foreseen rapid deterioration in the energy trade balance.

The main sectors contributing to GDP growth are expected to be manufacturing and services (especially tourism), and to a lesser extent, agriculture and fisheries. The relative weight of other sectors in the economy (particularly oil, mining, and government services) would decrease gradually, notably as a result of the shift of resources toward the nontraditional tradable goods sector. Reflecting this restructuring, the ratio of exports of non-energy goods and services to GDP is projected to increase from 26 percent in 1986 to 33 percent in 1991. The private sector is expected to account for more than 53 percent of total investment during 1988-91 compared with 44 percent in 1986-87.

The reduction in macroeconomic imbalances and the cautious monetary policy to be pursued by the authorities would allow for an even more rapid reduction in the rate of increase of the general price level except for the impact of significant adjustments to be made in administered prices and public tariffs which will lead to a onetime increase in prices. To the extent that these adjustments relate mainly to consumer goods and services, their adverse impact on the cost competitiveness of the Tunisian economy should be limited, given that the authorities will maintain a cautious wage policy.

During the period 1988-91, private consumption is projected to grow at an average annual rate of 2.9 percent in real terms, maintaining real consumption per capita roughly unchanged (Table 4). As this is less than the growth of GDP, and given the significant reduction in the government deficit, national savings are projected to increase from 19.8 percent of GDP in 1987 to 21.4 percent in 1991, following a temporary decline to 17.4 percent of GDP in 1988 related to the substantial loss of income in agriculture. As a result, additional domestic resources would be available to finance increased investment in accordance with program targets. Thus following the sharp decline of 29 percent in real terms from 1985 to 1987, investment over the program period would grow at an average annual rate of 5.8 percent in real terms, consistent with the external adjustment targets.

A reduced fiscal deficit is expected to contribute significantly to the external adjustment during the program period. The consolidated deficit of the Central Government (on a commitment basis, and including social security) is targeted to decline from 4.1 percent of GDP in 1988 to 2.3 percent in 1991, or slightly more rapidly than the current account deficit of the balance of payments (Table 5). In line with the strategy of reducing the weight of the Central Government in the economy, central government revenues will decline in relation to GDP, necessitating an even sharper decline in expenditures. According to present projections, the financial position of the rest of the economy is expected to remain broadly unchanged, as a deterioration in the private sector position related to its investment effort is projected to be offset by a gradual improvement in the public enterprise sector position. 1/

The implementation of the structural and macroeconomic adjustment program will lead to a consolidation of the balance of payments viability and to an improvement in the debt profile. After increasing in 1988 because of exogenous factors affecting agriculture, and as imports rebound from the exceptionally low level of 1987, the current account deficit is expected to drop steadily to 2.3 percent of GDP in 1991, which corresponds broadly to the projected level of grants and direct investment (Table 6). The external current account targets are predicated on the achievement of real average growth rates of 6.8 percent in non-energy exports and of 6.2 percent in non-energy imports. The growth projection for exports, somewhat in excess of projected aggregate demand of trading partners, 2/ is based on the assumption of increases in production capacity that would make possible further gains in market shares. These gains would reflect the lagged effects of the 25 percent real depreciation in the effective exchange rate during 1985-7 and further improvements in nonprice competitiveness. The relatively

---

1/ As discussed below, the IBRD intends to support a major undertaking in Tunisia to restructure the public enterprise sector.

2/ Partner demand projection, export and import prices, and interest rate assumptions are based on the estimates contained in the latest World Economic Outlook projections.

Table 4. Tunisia: Selected Macroeconomic Indicators, 1987-91

	1987	1988	1989	1990	1991
	(Annual percent change, at constant prices)				
GDP	5.8	0.9	5.1	4.3	3.7
Private consumption	0.9	2.0	3.0	3.2	3.4
Public consumption	2.2	1.0	2.4	1.9	2.0
Investment	-12.9	3.7	7.0	6.5	6.0
Exports of goods and services	14.0	5.7	4.6	5.4	4.4
Imports of goods and services	-4.1	9.0	2.5	3.8	2.9
	(In percent of GDP, at current prices)				
Investment (including stock-building)	21.2	21.2	22.6	23.3	23.7
Savings	19.8	17.4	19.2	20.5	21.4
Resource gap	1.4	3.8	3.4	2.8	2.3

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

Table 5. Tunisia: Medium-Term Fiscal Projections, 1987-91

	Est. 1987	Prog. 1988	Projections 1989	1990	1991
		(In millions of dinars)			
Revenue and grants	2,548.7	2,716.3	2,880.0	3,101.0	3,346.0
Tax revenue	1,914.9	2,039.3	2,260.4	2,489.9	2,725.2
Of which: social security contributions	(261.3)	(303.5)	(322.0)	(346.5)	(370.0)
Other revenue and grants 1/	633.8	677.0	619.6	611.1	620.8
Of which: petroleum-related	(356.2)	(368.0)	(352.0)	(336.0)	(327.0)
Total expenditure and net lending	2,835.7	3,066.3	3,215.0	3,405.0	3,613.0
Current	2,041.6	2,228.7	2,317.0	2,477.0	2,617.0
Capital and net lending	794.1	837.6	898.0	928.0	996.0
Deficit (commitment basis)	-287.0	-350.0	-335.0	-304.0	-267.0
Financing	287.0	350.0	335.0	304.0	267.0
Foreign (net)	100.6	237.0	220.0	181.0	121.0
Domestic (net)	186.4	113.0	115.0	123.0	146.0
Of which: banking system	(94.0)	(50.0)	(...)	(...)	(...)
		(Annual increase in percent)			
Revenue and grants	4.9	6.6	6.0	7.7	7.9
Tax revenue	2.0	6.5	10.8	10.2	9.5
Tax revenue (excluding social security contributions)	1.3	7.1	9.5	10.6	9.9
Other revenue and grants	14.8	6.8	-8.5	-1.4	1.6
Expenditure and net lending	2.4	8.1	4.8	5.9	6.1
Current	4.4	9.2	4.0	6.9	5.7
Capital and net lending	-9.1	5.5	7.2	3.3	7.3
		(In percent of GDP)			
Revenue and grants	31.9	32.1	30.5	29.7	29.2
Tax revenue (including social security contributions)	24.0	24.1	23.9	23.8	23.8
Tax revenue (excluding social security contributions)	20.7	20.5	20.5	20.5	20.5
Other revenue and grants	7.9	8.0	6.6	5.8	5.4
Petroleum revenues	4.5	4.4	3.7	3.2	2.9
Expenditure and net lending	35.5	36.3	34.0	32.6	31.5
Current	25.5	26.4	24.5	23.7	22.8
Capital and net lending	9.9	9.9	9.5	8.9	8.7
Deficit	-3.6	-4.1	-3.5	-2.9	-2.3
Foreign financing	1.3	2.8	2.3	1.7	1.0
Domestic financing	2.3	1.3	1.2	1.2	1.3

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

1/ Grants are of minor importance, averaging less than D 10 million in 1987-88; no grants are included in the projections for 1989-91.

Table 6. Tunisia: Balance of Payments, 1986-93

	1986	1987 Est.	1988	1989	1990	1991	1992	1993
			Projections					
			(In millions of SDRs)					
Current account	-601	-103	-289	-279	-251	-221	-198	-186
Trade balance	-833	-563	-770	-784	-819	-860	-918	-985
Exports, f.o.b.	1,507	1,653	1,672	1,785	1,931	2,058	2,227	2,459
Energy	365	390	300	289	279	224	193	195
Non-energy	1,142	1,262	1,372	1,496	1,652	1,834	2,034	2,264
Imports, f.o.b.	-2,340	-2,216	-2,442	-2,569	-2,750	-2,919	-3,145	-3,444
Energy	-202	-233	-205	-223	-252	-243	-258	-301
Non-energy	-2,138	-1,983	-2,236	-2,346	-2,498	-2,675	-2,887	-3,142
Nonfactor services (net)	286	462	513	544	602	672	742	816
Of which: tourism receipts	(414)	(517)	(586)	(632)	(683)	(741)	(803)	(872)
Transfers (net)	-54	-2	-32	-39	-35	-33	-23	-17
Of which:								
Receipts from workers' remittances	(308)	(352)	(347)	(353)	(364)	(376)	(385)	(398)
Interest on external debt	(-277)	(-272)	(-297)	(-314)	(-326)	(-345)	(-351)	(-364)
Capital account	432	193	366	353	303	271	251	236
Grants	35	29	27	31	30	25	24	24
Direct and portfolio investment (net)	132	78	86	96	127	149	162	173
Medium- and long-term borrowing (net)	177	46	253	227	146	98	65	40
Of which:								
Disbursements	(644)	(555)	(776)	(781)	(769)	(697)	(622)	(606)
Amortization	(467)	(510)	(522)	(554)	(623)	(599)	(557)	(566)
Short-term capital (including valuation adjustment, and errors and omissions)	67	68	—	—	—	—	—	—
Overall surplus or deficit (-)	-190	117	77	75	52	50	52	50
Changes in reserves (increase -)	190	-117	-77	-75	-52	-50	-52	-50
Use of Fund resources	150	41	47	64	-18	-51	-21	-12
Other items, net (increase -)	40	-158	-123	-138	-34	1	-31	-38
			(In percent of GDP)					
Memorandum items:								
Current account deficit (-)	-8.0	-1.4	-3.8	-3.4	-2.8	-2.3	-1.9	-1.7
Gross reserves (in months of imports)	1.3	2.0	2.5	3.0	2.9	2.7	2.6	2.5
Debt service ratio	27.9	26.2	26.4	26.2	28.9	27.2	22.5	20.8
Debt/GDP ratio	56.1	57.8	60.6	59.5	56.8	53.7	50.2	46.9
			(Annual changes in percent)					
Principal assumptions								
Real GDP	-1.6	5.8	0.9	5.1	4.3	3.7	4.7	4.4
Inflation (GDP deflator)	3.3	7.6	4.9	6.5	6.0	5.7	5.3	5.1
Real effective exchange rate (- depreciation)	-14.5	-13.8	-1.9	...	...	...	...	...
Export volumes	5.7	9.1	3.3	3.9	4.5	3.3	5.2	6.4
(Non-energy exports)	11.8	13.3	6.2	7.0	6.6	7.4	7.2	7.4
Import volumes	2.0	-2.9	9.2	1.9	3.9	2.8	4.5	6.1
(Non-energy imports)	1.0	-8.8	8.5	5.6	4.2	6.6	5.4	5.0

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

rapid growth of imports assumed in the projection takes account of the investment cycle and the import liberalization process. The overall favorable medium-term prospects would be achieved despite the projected substantial deterioration in the energy trade balance, the investment cycle required to restructure the productive system, and the peaking of interest payments on the foreign debt in 1989-90. Excluding the impact of the adverse shift in the energy trade balance, the current account deficit is projected to drop from 4.9 percent of GDP in 1988 to 2.0 percent in 1991.

Net capital inflows would allow a further accumulation of gross reserves, which are targeted to increase from the equivalent of 2 months of imports in 1987 to the equivalent of 2.7 months by 1991. Grants would continue to be a relatively modest financing item, whereas gross direct investment from abroad is projected to almost double between 1987 and 1991. Taking account of the larger debt amortization and the replenishment of official reserves during the program period, recourse to gross external borrowing in the form of medium- and long-term credits is projected to increase to about SDR 775 million per year in 1988-90, before dropping back rapidly starting from 1991. The authorities are seeking to shift the composition of capital inflows toward concessional long-term resources in an attempt to accelerate the improvement in the debt profile. After a relatively stable pattern in 1988-89, the debt service ratio, in terms of total exports of goods and services, and including obligations to the Fund, is projected to peak at close to 29 percent in 1990, before dropping back rapidly thereafter. Debt service payments have been effected at the original due dates. Outstanding debt in relation to GDP would be reduced from 57.8 percent in 1987 to approximately 53.7 percent in 1991 and is projected to decline rapidly thereafter (Table 7). Gross reserves are projected to increase while accommodating projected significant repurchase obligations to the Fund in 1990-91.

2. Financial and structural policies for 1988-91

a. Fiscal policies

As noted above, the authorities' strategy of focusing on the promotion of private sector initiative and rigorous management of public sector resources will entail a gradual reduction in the role of the central government sector. Central government total revenues and grants are projected to decline from 31.9 percent of GDP in 1987 to 29.2 percent of GDP in 1991 reflecting in part a decline in oil revenues, while central government total expenditure and net lending is projected to drop from 35.5 percent of GDP in 1987 to 31.5 percent in 1991. Reflecting the more rapid decline in budgetary expenditure, together with a reduction in the deficit of the social security system, the central government consolidated deficit (on a commitment basis) will be reduced from 4.1 percent of GDP in 1988 to 3.5 percent in 1989, 2.9 percent in 1990, and 2.3 percent in 1991.

Table 7. Tunisia: Medium-Term External Debt Projections, 1986-93

	1986	1987 Est.	1988	1989	1990	1991	1992	1993
			Projections					
			(In millions of SDRs)					
Total debt service	745	782	820	868	1,031	1,043	930	942
Interest	277	272	297	314	326	345	351	364
Principal	467	510	522	554	705	698	578	578
Of which:								
IMF	—	8	13	16	100	115	36	26
Charges	—	8	13	16	18	16	15	14
Repurchases	—	—	—	—	82	99	21	12
			(In percent of current receipts)					
Total debt service	27.9	26.2	26.4	26.2	28.9	27.2	22.5	20.8
Interest	10.4	9.1	9.6	9.5	9.1	9.0	8.5	8.1
Principal	17.5	17.1	16.8	16.7	19.7	18.2	14.0	12.8
Excluding IMF	27.9	25.9	26.0	25.7	26.1	24.2	21.6	20.3
Interest	10.4	8.9	9.2	9.0	8.6	8.6	8.1	7.7
Principal	17.5	17.1	16.8	16.7	17.4	15.6	13.5	12.5
Total interest in percent of GDP	3.7	3.7	3.9	3.8	3.7	3.6	3.4	3.3
IMF debt service in percent of gross reserves	—	2.1	2.6	2.5	15.2	17.5	5.2	3.5
			(In millions of SDRs)					
Total debt outstanding	4,229	4,315	4,615	4,906	5,034	5,081	5,125	5,153
Excluding IMF	4,079	4,125	4,378	4,605	4,751	4,849	4,914	4,954
Of which (in percent):								
Long-term	(59)	(65)	(71)	(75)	(79)	(82)	(82)	(84)
Medium-term	(41)	(35)	(29)	(25)	(21)	(18)	(18)	(16)
IMF	150	191	238	301	282	211	204	199
			(In percent of GDP)					
Total debt	56.1	57.8	60.6	59.5	56.8	53.7	50.2	46.9
Excluding IMF	54.1	55.3	57.5	55.8	53.6	51.2	48.1	45.1
IMF	2.0	2.6	3.1	3.7	3.2	2.4	2.1	1.8

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

Central government revenues are projected to increase at an average rate of some 7 percent during the program period. While some uncertainties remain as to the revenue impact of the major tax reforms, particularly regarding the introduction of a value-added tax (VAT) in July 1988 (see Section IV.1 below), the authorities intend to strengthen tax administration and to adjust the rates and the base of the VAT in 1989, if necessary, to compensate for any revenue loss. Furthermore, the reform of direct taxes (both personal income and corporate profit taxation) would be carried out with an objective of revenue neutrality. Therefore, the tax to GDP ratio (excluding social security contributions) is expected to be stabilized at about 20.5 percent over the program period. The authorities intend to take additional revenue measures if needed to achieve this target. Nontax revenues are projected to decrease from 8 percent of GDP in 1988 to 5.4 percent in 1991, mainly because of the expected decline in petroleum revenues.

Central government expenditure and net lending is projected to increase by an average of 6.2 percent per year and to remain virtually unchanged in real terms during the program period. The average annual growth of the wage bill might reach 7 percent compared with an average annual inflation rate of 6.2 percent because the productivity premium for civil servants is to be re-evaluated in two stages during 1988-89, while recruitments are not to exceed 2 percent per year on average. These projections imply that salaries of most civil servants are likely to stagnate or even decrease slightly in real terms. While total subsidies and transfers 1/ are projected to grow by 5.5 percent on average, a strong effort will be made to reduce consumer subsidies given by the Caisse Générale de Compensation. Consistent with the objective stated in the Seventh Development Plan, the authorities will seek to reduce consumer subsidies by 5 percent annually during 1988-91, and intend as a minimum to limit them to their 1987 level of D 185 million per year, which would represent a significant decline in real terms. 2/ In reducing consumer subsidies, the authorities intend to safeguard the poorest segments of the population to the extent possible by concentrating initially on the elimination of subsidies on goods of lesser necessity. Expenditures on goods and services will be kept constant in real terms. The small amounts of existing domestic arrears will be eliminated in 1988 and the authorities will ensure that no new domestic arrears will be accumulated during the program period. The growth of capital expenditure and net government lending will be limited to an average annual rate of about 6 percent.

b. Tax reform

The Tunisian authorities are launching a comprehensive tax reform to be implemented during the program period with the following three

---

1/ A significant part of which is to other levels of government.

2/ In the absence of price adjustments for subsidized goods, total consumer subsidies have been projected at an average annual level of D 290 million.

main objectives: (i) to put in place a transparent and flexible instrument for fiscal policy; (ii) to streamline the incentives to the private sector and eliminate distortions emanating from the multiplicity of levies; and (iii) to improve the equitability of tax application and the efficiency of tax collection. The tax reform package will cover both indirect and direct taxes, and will be broadly in line with the recommendations of a Fund technical assistance mission in 1985.

The present system of indirect taxation in Tunisia consists of three turnover taxes (a production tax, a consumption tax, and a service tax) together with an array of excise taxes. There is little deductibility between these taxes and, compounded, they have 45 rates: 22 ad valorem and 23 specific. As of July 1, 1988 this system will be replaced by a VAT with three rates: a general rate of 17 percent applying to most goods and services, a reduced rate of 6 percent for basic consumer goods and professional services, and a higher rate of 29 percent applied to the remaining goods. In addition, a zero rate would apply to exports, while agriculture would be formally exempt. In order to avoid any substantial revenue loss, an additional consumption tax in the form of excise duties will be levied on a number of products to be taxed at the high VAT rate. These duties will be temporary except those for tobacco, alcoholic beverages, petroleum products, and a few luxury products. On January 1, 1989, the VAT will be extended to wholesale trade activities with a turnover greater than D 500,000.

The existing traditional schedular form of taxation, in which the personal income tax is imposed at different rates according to the type of income, has proved cumbersome and has led to substantial tax evasion and high marginal rates (68 percent for commercial and industrial activities, 65 percent for noncommercial activities taxed under the forfeit rules, and 64 percent for wages and salaries). Moreover, the self-employed have been escaping taxes, and wage earners, subject to tax withholding, have been benefiting from increasing fringe benefits that are tax exempt. This system will therefore be replaced with a new single personal income tax with a much simpler rate structure and a reduced number of brackets. The maximum marginal rate would be reduced to 50 percent, and fringe benefits of wage earners would be gradually included in the tax base over the medium term. This would be done in such a way as to ensure revenue neutrality to the Government. A draft law under preparation should be presented to Parliament in August 1988, and its operational aspects will be discussed with the Fund staff during the first program review. It will become effective in 1989 on income earned in 1988.

The authorities are preparing a draft law to simplify the structure of corporate tax income and reduce the maximum rate. This reform is also planned for implementation in 1989 with application on 1988 profits. Taxation of corporate income presently takes two forms: a minimum tax payable with 1 percent of turnover, and a tax on profits with a maximum rate of 38 percent for industrial activities and 44 percent for commercial activities. In addition, a general tax and a

solidarity contribution are among other instruments levied on dividends and interest. The compounded rate of all these cumulative forms of taxation could reach 82 percent for a commercial activity and 80 percent for an industrial activity. To reduce the tax burden, a system of tax credit was introduced in 1988, tax rates on dividends and interest were reduced to a unified rate of 20 percent, and the solidarity contribution on dividends and interests was abolished.

The authorities also intend to continue their customs tariff reform (see below).

c. Financial sector policies

In conducting monetary policy, the authorities will aim at improving the interplay of market forces in the determination of interest rates, after having already eliminated during the previous program their past reliance on direct controls on credit. An important step was the opening, in January 1988, of the money market to transactions among banks and nonfinancial institutions. In 1989 the depth of the money market will be further improved by the introduction of treasury bills. These bills will offer a competitive interest rate and maturity structure and will reduce gradually the weight of equipment bonds in the financing of the Government. The authorities have requested Fund technical assistance in the implementation of this reform. Consistent with this new institutional setting, the Central Bank will monitor, and, when necessary, influence the liquidity of the banking system through its interventions in the money market. In determining its interest rate policy, the Central Bank will take into account external and price developments.

The authorities will seek to reduce the distortions in the interest rate structure by gradually phasing out all parafiscal levies on interest charges, as well as the gap between preferential interest rates and the money market rate. 1/ Over the next few months, the authorities plan to study, also with technical assistance from the Fund, the existing level of competition among financial intermediaries and to evaluate the overall performance of the banking system. In light of the results of this study, the authorities intend to take additional measures in 1989, including the gradual phasing out of the present cap of 3 percent above the money market rate for all lending interest rates. 2/

d. External sector policy

The flexible exchange rate policy pursued in 1986-87 significantly boosted external competitiveness and helped promote structural adjustment. The authorities feel that at this stage emphasis should be placed

---

1/ Some 25 percent of credit (to agriculture, small scale industries, and export activity) is extended at preferential rates.

2/ This 3 percent cap on lending rates excludes bank commissions, and fiscal and parafiscal levies.

on improvements in nonprice competitiveness and increases in the production capacity in the tradable goods sector, notably in nontraditional export industries, so as to enable economic agents to seize new market opportunities opened by the substantial real effective depreciation of the dinar in 1986-87. Exchange rate policy will continue to be administered flexibly and, as a minimum, the real effective exchange rate will be maintained at its end-1987 level. Moreover, the authorities will consider further exchange rate adjustments should the balance of payments and foreign exchange reserves come under pressure.

The authorities are aiming at developing adequate instruments to promote an efficient allocation of foreign exchange resources. Among the various possibilities, they are considering the introduction of an interbank market in foreign exchange and, as a first step in this direction, will allow some degree of flexibility in the surrender of foreign exchange export proceeds. The authorities are concerned about the sizable exchange rate-related losses of the private and public enterprises caused by the devaluation of the dinar in August 1986 and the subsequent depreciation against the reference basket. Moreover, the full exchange rate risk guarantee extended by the Government to development banks has created significant losses for the budget. On the basis of information available to the staff, the operation of this guarantee scheme gave rise to a multiple currency practice. Recently, the authorities have decided to eliminate the present exchange guarantees scheme and to put in place a new system to help economic agents to hedge against the exchange rate risk in the future.

The new exchange risk cover system will be based on the following economic principles: First, economic agents will bear the exchange risk that derives from their choices to assume liabilities denominated in foreign currencies. Second, given existing exchange system regulations, the Central Bank of Tunisia will assume the responsibility of providing hedging facilities to economic agents on the international capital markets. The cost of these facilities, however, will be borne by the recipient and any loss for the budget will be reduced to a minimum. Finally, the hedging facilities provided by the Central Bank will be established in a way that will facilitate their transformation into market-determined instruments.

The program of foreign trade liberalization initiated in 1986 has aimed at helping more efficient production management in enterprises using imported inputs, and at increasing the exposure of local industries to foreign competition in order to stimulate gains in productivity as well as improvements in product quality. 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 1/ and a minimum at 17 percent. The average tariff is currently at about 27 percent, and the authorities are

1/ Including 2 percent for the customs formality tax and the special tax for export promotion.

targeting an average tariff rate of 25 percent in 1991, which will be achieved under a revenue neutrality constraint.

In January 1988, the import liberalization process was continued with the freeing of most capital goods from administered controls. Thus, as of January, imports of raw materials, spare parts, semi-finished products, and capital goods are now liberalized, with the exception of certain goods, most of which are produced by infant industries or imported by other industries that are weakly integrated. 1/ During the program period the authorities will liberalize, according to an established timetable (Appendix IV), all remaining imports except certain goods (luxury products, goods that are considered strategic or for which there is an import monopoly such as cereals and petroleum products, and certain goods produced by infant industries). Thus, liberalized import categories will account for at least 80 percent of total imports in 1991. This implies an extensive liberalization of consumer goods and most other goods that have not yet been liberalized, which should increase substantially the exposure of local industries to foreign competition. 2/

e. Pricing policy

Pricing policy will continue to be aimed at promoting economic growth through an efficient use of resources. In agriculture, the authorities will continue to adjust input prices as well as certain administered producer prices, mostly cereals, to reflect cost developments and encourage domestic production. Producer prices are already free for some 80 percent of agricultural production and the scope for further liberalization in this sector is limited by the strategic importance attached to the cereal market by the authorities. Similarly, regular adjustments will be made in public tariffs in line with the objectives of the public enterprise sector reform. Other administered prices, petroleum products and subsidized consumer goods, will also be adjusted with a view to supporting the fiscal adjustment effort.

The liberalization of industrial producer prices will be continued, according to an established timetable, and the goods concerned will account for at least 75 percent of manufacturing production by end-January 1991, compared with some 55 percent at end-January 1988. Thus by 1991, all industrial prices will be free of control at the production level, except for certain strategic and sensitive products such as petroleum products, water, electricity and cereal derivatives. In order to carry out this policy successfully, the authorities intend to make

---

1/ The Government's policy is to define new activities as infant industries and in exceptional cases to grant non-tariff protection for up to 3 years. "Weakly integrated" industries are those heavily reliant on imported inputs such as the recently closed passenger car assembly plant.

2/ Imports of food and petroleum products accounted for 21 percent of imports in 1987.

quick progress on import liberalization so that foreign competition may be a safeguard against rapid increases in domestic producer prices. The liberalization process will be supported by the freeing of distribution margins for commodities accounting for at least 50 percent of manufacturing production by end-January 1991, compared with the present full government control of these margins.

f. Public enterprise sector reform

The public enterprise sector has a major weight in the Tunisian economy, contributing between one fourth and one third to employment creation, GDP, and investment. While a comprehensive overview is not possible because of lack of adequate data, a recent survey of 35 major enterprises suggests that the performance of this sector deteriorated sharply in the 1980-86 period. While some of the difficulties are specific to particular enterprises, many are of a general nature deriving from a lack of management autonomy and heavy dependence on public sector demand and on budgetary support of these enterprises.

During the program period, the authorities intend to strengthen the reform process initiated in 1986. The objectives of the reform are threefold. First, the institutional environment of the enterprises will be improved by limiting further the scope of government control to those enterprises with more than 50 percent government equity shareholding (from the present level of 33 percent). Moreover, Boards of Directors will be granted more autonomy in management, more flexibility will be introduced in personnel policies, and, where possible, relations with the Government will be formalized through the elaboration of performance contracts. Second, the administration of the divestiture process through privatization and liquidation of enterprises, which has been initiated on an ad hoc basis, will be streamlined by centralizing the decision-making process and by drawing up a medium-term program. The scope for privatization is, however, limited by the small size of the Tunisian stock market, the operation of which is being strengthened in collaboration with the International Finance Corporation and the United Nations Development Program. Thus far, of the 35 enterprises examined by the National Commission for the Restructuring of Public Enterprises, decisions have been made to privatize nine, liquidate three, and rehabilitate the remainder. Third, specific restructuring programs will be implemented for certain major enterprises that are bound to remain in the public sector and that account for a substantial part of the sector's total losses, notably the phosphates mining company (CPG), the phosphate derivatives industry (Groupe Chimique), and the railway company (SNCFT). The restructuring will involve refocusing the production and marketing strategies of the companies, reducing their operating costs (including personnel costs), and reorganizing their financial structure through the provision of adequate working capital and the elimination of accumulated losses. For the specific case of public utility agencies (notably electricity, water, and transports), regular tariff adjustments will be made to cover increases in costs. As a general objective, the restructuring of enterprises remaining in the

public sector is aimed at achieving financial balance over time, including the full assumption of their own debt service and investment programs.

The authorities are preparing specific timetables for reforms in the various areas in collaboration with the World Bank, which will support the process with a public enterprise restructuring loan (PERL), likely to be negotiated before the end of 1988. The content of the reform package, including the operational arrangements and the budgetary implications, will be discussed with the Fund staff during the program reviews.

g. Incomes and employment policies

The authorities intend to maintain a cautious incomes policy so as to support the progress being made in reducing inflation and unemployment. They will, therefore, endeavor to avoid any slippage in wage policy that by unduly raising production costs would harm external competitiveness and hamper job creation. To this end, the real increase in the wage index during the program period will remain, on average, below that of GDP, and wage raises will continue to be linked to productivity gains. Social security transfers to households will also be maintained under firm control, with the dual objectives of limiting charges to businesses and preserving a sound financial balance for the social security system.

Employment policy will remain geared toward the restructuring of the economy, and new job creation is expected to take place, especially in the tradable goods sector. In order to reduce certain rigidities in the labor market, the authorities have developed a number of incentives for hiring young people and job creation schemes in the less developed regions. The budgetary cost of these various initiatives will be limited. In particular, a four-year program for the creation of 100,000 jobs (for the unskilled unemployed) will be financed essentially with concessional foreign aid and will be kept within the agreed overall budgetary limits. The objectives of these initiatives are to establish the conditions for creating genuine employment opportunities in the non-government productive sectors.

IV. The Program for 1988

The macroeconomic objectives for 1988 are: (i) to achieve real growth of GDP of about 1 percent; (ii) to reduce inflation (average annual increase in the general consumer price index) to 6.5 percent, compared with 8.2 percent in 1987, notwithstanding the continued liberalization of prices and a significant adjustment in controlled prices; and (iii) to limit the external current account deficit to 3.8 percent of GDP, despite the adverse exogenous factors affecting the agricultural sector, and a continued deterioration in the energy trade balance.

The above targets are unchanged from those drawn up at the beginning of the year in the context of the third review of the recently expired stand-by arrangement, with the exception of the rate of growth. The latter has been revised downward, as the impact of the drought and the invasion of locusts is now estimated to be more severe than initially foreseen, leading to a drop of 15 percent in value added in the agricultural sector at constant prices. Other sectors (excluding agriculture and petroleum) are projected to grow by about 4 percent in real terms. Developments in the first few months of the year have been in line with the established targets. The rate of inflation over the 12 months ending March 1988 was some 6 percent, and exports of non-energy goods and tourism have shown continued strong growth; the seasonal decline in net foreign reserves during the first quarter was SDR 28 million less than foreseen.

1. Fiscal policy in 1988

As a result of the various tax reform measures entailing revenue losses that are only partially compensated by new revenue measures, fiscal developments in 1988 will be less favorable than in 1987. At the same time, total expenditure and net lending includes a special payment of D 40 million to the development banks to compensate for their exchange rate losses incurred since the 1986 dinar depreciation, and increased financing of the operating losses of the phosphate and chemical companies, which had previously been financed by bank borrowing. Reflecting these factors, the overall consolidated deficit of the Central Government (on a commitment basis) is projected to increase to D 350 million, or 4.1 percent of GDP, compared with 3.6 percent of GDP in 1987 (Table 8).

In view of the more severe than initially foreseen effects of the drought and the locust invasion in rural areas, the Government is under an obligation to provide some relief to the most affected sectors. Accordingly, a supplementary finance law involving additional expenditures of some D 30 million (equivalent to 0.4 percent of GDP) will be submitted for parliamentary approval in July. It is expected to contain provisions to support the small-scale livestock sector, to finance the fight against locusts, and to put in place temporary employment programs in the most affected rural areas. The latter would only partially compensate for the loss of employment caused by the drought, currently estimated at the equivalent of 55,000 man years. About half of these expenditures will be covered by identified foreign grants and a special national solidarity contribution of public sector employees, while the rest will be financed through additional foreign and domestic nonbank resources. If the remainder were financed by borrowed resources, the additional expenditures could lead to an increase of the projected 1988 fiscal deficit of some D 14 million (equivalent to 0.2 percent of GDP). However, the authorities have indicated that they intend, through procurement of additional foreign grants and expenditure cutbacks in other areas, to achieve the program target of a fiscal deficit of D 350 million (4.1 percent of GDP).

Table 8. Tunisia: Consolidated Financial Operations of the Central Government, 1984-88 1/

	1984	1985	1986	Revised Program 1987 2/	Estimate 1987	Program 1988
			(In millions of dinars)			
Revenue and grants	2,285.4	2,450.9	2,430.0	2,564.3	2,548.7	2,716.3
Tax revenue	1,652.3	1,832.2	1,877.7	1,932.7	1,914.9	2,039.3
On international transactions	(647.4)	(656.2)	(606.2)	(624.0)	(618.2)	(652.5)
Other	(1,004.9)	(1,176.0)	(1,271.5)	(1,308.7)	(1,296.7)	(1,386.8)
Other revenue and grants	633.1	618.7	552.3	631.6	633.8	677.0
Non-petroleum-related	(248.7)	(239.0)	(239.6)	(257.6)	(277.6)	(274.0)
Petroleum-related	(384.4)	(379.7)	(312.7)	(374.0)	(356.2)	(403.0)
Total expenditure and net lending	2,655.2	2,764.3	2,828.8	2,902.7	2,835.7	3,066.3
Current 3/ 4/	1,761.1	1,914.3	1,955.4	2,094.8	2,041.6	2,228.7
Wages and salaries	(633.2)	(691.4)	(743.8)	(777.7)	(778.6)	(857.1)
Goods and services	(232.8)	(215.4)	(182.7)	(218.5)	(212.1)	(233.3)
Interest payments	(168.5)	(196.0)	(223.6)	(268.4)	(245.1)	(272.1)
Subsidies and transfers	(726.6)	(811.5)	(805.3)	(830.2)	(805.8)	(866.2)
Of which:						
Consumer subsidies 5/	(255.1)	(232.2)	(213.0)	(184.0)	(183.2)	(183.0)
Transfers, other than to households	(273.8)	(359.5)	(301.3)	(312.3)	(315.3)	(331.3)
Capital and net lending	894.1	850.0	873.4	807.9	794.1	837.6
Direct investment	(318.7)	(314.3)	(393.6)	(338.6)	(321.1)	(370.8)
Capital transfers and equity	(267.6)	(368.7)	(314.2)	(305.5)	(312.6)	(361.3)
Net lending	307.8	167.0	165.6	163.8	160.4	105.5
Deficit (commitment basis) 6/	-369.8	-313.4	-398.8	-338.4	-287.0	-350.0
Adjustment for the complementary period	16.0	57.1	78.3	-15.0	...	...
Deficit (payment-order basis) 7/	-353.8	-256.3	-320.5	-353.4	-287.0	-350.0
Financing	353.8	256.3	320.5	353.4	287.0	350.0
Foreign	207.0	212.4	213.7	207.0	100.6	237.0
Drawings	(377.4)	(418.6)	(470.6)	(510.0)	(393.6)	(560.0)
Budgetary	(112.9)	(215.6)	(230.6)	(274.0)	(185.6)	(330.0)
Extrabudgetary	(264.5)	(203.0)	(240.0)	(236.0)	(208.0)	(230.0)
Amortization	(-170.4)	(-206.2)	(-256.9)	(-303.0)	(-293.0)	(-323.0)
Domestic	146.8	43.9	106.8	146.4	186.4	113.0
Banks	(97.0)	(102.5)	(72.7)	(91.0)	(94.0)	(50.0)
Other 8/	(49.8)	(-58.6)	(34.1)	(55.4)	(92.4)	(63.0)
Memorandum items:						
GDP	6,289.0	6,842.0	7,026.0	7,965.0	7,993.0	8,455.0
			(In percent of GDP)			
Revenue and grants	36.3	35.8	34.6	32.2	31.9	32.1
Expenditure	42.2	40.4	40.3	36.4	35.5	36.3
Deficit (commitment basis)	-5.9	-4.6	-5.7	-4.2	-3.6	-4.1
Deficit (payment-order basis)	-5.6	-3.7	-4.6	-4.4	-3.6	-4.1

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

1/ Includes current and capital budgets, Special Funds, Fonds de Concours, extrabudgetary operations financed abroad, net treasury operations, and social security funds.
2/ EBS/87/200.
3/ On a payment orders issued basis for the budget year, including expenditure of the complementary period; the data coincide closely with the commitments of the calendar year.
4/ Figures for 1984-86 do not include accumulation of domestic arrears at early stages of the expenditure process, amounting to a float of about D 15 million; the expenditure figure for 1987 includes a provision of D 14 million for the elimination of such arrears and the figure for 1988 includes a provision of D 12 million.
5/ Figures include subsidy costs financed by net treasury advances; corresponding adjustments have been made to net lending.
6/ Reflecting content of footnote 3.
7/ Payment orders issued in the calendar year.
8/ Including payment float.

Net foreign borrowing is projected to increase in 1988 to D 237 million, on the basis of credit lines put in place in 1987, and would cover about 68 percent of the total fiscal deficit. Taking into account nonbank domestic financing in the form of a public loan (D 35 million) and purchases of equipment bonds by nonbank financial institutions (D 28 million), bank financing will be reduced from D 94 million in 1987 to D 50 million in 1988, or the equivalent of 1.3 percent of the money stock outstanding at end-1987.

Overall government revenues are projected to increase by 6.6 percent in 1988, remaining roughly unchanged in relation to GDP. Revenue projections include proceeds from new revenue measures, and consist of (1) an increase in domestic petroleum prices (expected to yield D 35 million); (2) a nonrecurrent special contribution by commercial banks to the Special Fund for the Guarantee of Exchange Rate and Interest Rate Risks (estimated at D 15 million) to help cover past losses of the Fund; (3) a restructuring of the customs tariff, entailing a moderate adjustment in the intermediate rates between 17 percent and 25 percent (expected to yield D 14 million); and (4) an increase in certain excise taxes (expected to yield D 10 million). However, these measures, estimated to yield some D 64 million, would not totally offset the revenue losses expected from various tax reform measures announced by the authorities, which are currently estimated at D 76 million. These measures include (1) implementation of the second step of the customs tariff reform (estimated revenue loss of D 22 million); (2) a reduction by 60 percent of the service tax rate on interest charges from 14.29 percent to 6 percent (estimated revenue loss of D 30 million); (3) a reduction of the real estate registration fee rate from 15.6 percent to 6 percent (a revenue loss of about D 10 million); and (4) a decrease in the tax rates on dividends and interest (IRVM) from 37.5 percent on common stocks and 29.5 percent on bonds to a unified rate of 20 percent, and abolition of the solidarity contribution on dividends and interest (an estimated revenue loss of D 14 million).

A major uncertainty regarding the 1988 revenue prospects relates to the introduction of the VAT, which is scheduled for July. It is difficult to predict whether the introduction of the VAT will result in a revenue loss. In any event, the authorities expect any shortfall to be offset by a strengthened tax administration and by the positive effects on revenues of the relatively generous tax amnesty announced in late 1987, which should strengthen investor confidence and bring potential taxpayers into the tax system, while reducing tax evasion. Under the amnesty, taxpayers who had not declared their income for the past four years had until January 16, 1988 to regularize their position. Such taxpayers will not be subject to a tax audit or penalty for overdue taxes and will be allowed to pay the tax due over a period of five years, with the provision that their tax liability could be reduced by up to 50 percent through investment in priority sectors or purchases of shares in public enterprises.

Total expenditure and net lending is projected to increase by some 8 percent in nominal terms, increasing slightly in terms of GDP, from 35.5 percent to 36.3 percent. The wage bill is expected to rise by 10 percent as a result of: (1) a re-evaluation of the productivity premiums, corresponding to a 3 percent wage increase after a four-year wage freeze; (2) a 2.9 percent increase in the number of civil servants to meet the needs of the education and health sectors; and (3) the effect of normal career progress. For the period 1987-88, government sector employment growth remains in line with the objective of limiting the average annual growth rate to 2 percent. Budgetary appropriations also include D 12 million to eliminate remaining domestic arrears and a 10 percent increase in the allocations for materials and supplies to ensure that new arrears will not arise. Expenditures for subsidized goods will be kept unchanged in nominal terms, which necessitates price increases of some D 21 million for certain subsidized goods during the year. Total capital expenditure and net lending is projected to rise by 5.5 percent; capital expenditure and equity participations are estimated to increase by some 15 percent, reflecting the authorities' intention to increase investment in priority sectors, and net lending, particularly to public enterprises, is estimated to decline by 34 percent.

2. Credit and monetary policies

For 1988, the authorities intend to reduce the rate of expansion of broad money to 9 percent from 13.7 percent in 1987, or slightly above the increase in domestic demand (Table 9). In line with the targeted increase of D 85 million in net foreign assets, domestic credit expansion will be limited to 8.7 percent. As credit expansion to the Government is to be reduced to D 50 million, the program allows for a somewhat higher rate of credit expansion to the rest of the economy (9 percent) in order to accommodate the projected resumption of private investment.

In a continuation of the gradual liberalization of the financial system, the requirement of prior approval from the Central Bank for refinanceable credit and for transactions in excess of D 5 million was abolished in January 1988. At the same time, the functioning of the money market was significantly enlarged through the authorization of interbank operations and the granting of access of other financial institutions and certain large nonfinancial companies through the issue of certificates of deposit and commercial paper. Reflecting market conditions, the central bank intervention rate 1/ has eased slightly since the reorganization of the money market, to 9 5/16 percent in mid-April; interbank transactions generally fluctuate around 1/8 of 1 percentage point above this rate. The introduction of the VAT in July 1988 will effectively reduce interest costs to those enterprises

1/ The Central Bank injects liquidity into the market every two weeks at a rate determined by bidding among banks. Subsequently, banks with liquidity needs provision themselves in the interbank market, but may have access to additional central bank financing at a penalty rate.

Table 9. Tunisia: Monetary Survey, 1985-88

	1985	1986	1987					1988				
			April	June	Sept.	Dec.		Feb.	March	June	Sept.	Dec.
						Act.	Prog.	Act.	Program			
	(In millions of dinars; end of period)											
Monetary system												
Net foreign assets	201	54	-60	-51	183	176	154	84	43	85	230	261
Central bank	209	38	...	-83	155	145	137	...	12	54	199	230
Deposit money banks	-8	16	...	32	28	31	16	...	32	31	31	31
Domestic credit	3935	4263	4292	4371	4327	4600	4714	4518	4692	4796	4872	4999
Net credit to the Govt.	554	627	600	665	606	721	718	693	721	760	737	771
Credit to the economy	3381	3636	3692	3706	3721	3879	3996	3825	3971	4036	4135	4228
Money plus quasi-money	3091	3266	3134	3207	3414	3713	3693	3551	3620	3632	3853	4047
Money	1987	2058	1637	1689	1802	2025	...	1720	...	...	...	...
Quasi-money	1103	1208	1497	1518	1612	1688	...	1831	...	...	...	...
Other items net	1046	1051	1098	1114	1096	1062	1175	1057	1115	1249	1249	1213
Memorandum items:	(In percent)											
Change over same period of previous year												
Domestic credit	17.2	8.3	8.1	8.2	8.9	7.9	10.6	5.3	11.0	9.7	12.6	8.7
Net credit to the Govt.	23.0	13.2	8.9	11.1	21.8	14.9	14.4	9.8	21.0	14.3	21.6	6.9
Credit to the economy	16.3	7.5	8.0	7.7	7.1	6.7	9.9	4.5	9.4	8.9	11.1	9.0
Money plus quasi-money	13.8	5.7	7.1	7.9	14.7	13.7	13.1	13.9	17.6	13.3	12.9	9.0
Money	12.6	3.5	-6.1	-5.9	-0.1	-1.6	...	-0.5	...	...	...	...
Quasi-money	16.1	9.5	26.5	29.0	37.6	39.7	...	31.6	...	...	...	...

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

subject to the VAT by 0.8 percentage points, since they will be able to deduct VAT payments on interest charges, whereas the TPS on interest charges was not deductible. As a result, the maximum interest costs to those sectors (including parafiscal charges and commissions) will be effectively reduced to about 14.0 percent in nominal terms, or about 7.5 percent in real terms.

3. External sector policies

The authorities hope to consolidate in 1988 a large part of the progress toward external equilibrium realized in the previous year: the current account deficit, which in 1986 was equivalent to 8 percent of GDP and in 1987 improved dramatically to the equivalent of only 1.4 percent of GDP, is projected to be contained at SDR 289 million, an amount equivalent to 3.8 percent of GDP (Table 10). The difficult situation of the agricultural sector will negatively affect the external sector, and in volume terms, imports of foodstuffs will increase by more than 28 percent while exports of agricultural products will decline by 1 percent. The structural deterioration of the energy trade balance will continue in 1988, with a decrease of export volumes of about 3 percent, while import volumes continue to grow, albeit at a moderate pace (1 percent). All other exports (excluding energy and agriculture) should be able to consolidate the good results of 1987 and to grow at a fast rate in volume terms of above 6 percent; preliminary data for the first few months of the year indicate that this target should be achieved.

The rebound of domestic demand and the projected acceleration of investments, together with the increasing demand for foreign inputs by the new exporting industries, will result in larger imports. In addition, it is expected that the acceleration of the liberalization process envisaged in the program, although partially compensated by the effect of the depreciation of the exchange rate, will have the same effect. Total imports, excluding energy and agriculture, are projected to grow at 7.4 percent in volume terms.

The first few months of the year appear to confirm the good performance of the tourist industry initiated in 1987. The extension of the tourist season to the winter and spring months, and the improvement of relations with Libya that has favored the reopening of regional tourist traffic, are the factors contributing to the fast growth of tourism receipts, which is projected at 13 percent in real terms for 1988. Workers' remittances are expected to remain roughly unchanged, as the effect of the stock adjustment consequent to the devaluation of the dinar diminishes.

The envisaged increase in investment will require the support of significant net capital inflows to Tunisia. Official and private medium- and long-term borrowing is projected to increase by 40 percent, from SDR 555 million in 1987 to SDR 776 million in 1988, of which SDR 540 million represents already contracted loans and the rest, new

Table 10. Tunisia: Balance of Payments, 1984-88

(In millions of SDRs)

	1984	1985	1986	1987 Program 1/	1987 Revised	1988 Program
			(In millions of SDRs)			
Current account	-854	-573	-601	-435	-103	-289
Trade balance	-1,199	-829	-833	-708	-563	-770
Exports, f.o.b.	(1,758)	(1,703)	(1,507)	(1,589)	(1,653)	(1,672)
Energy	778	712	365	388	390	300
Non-energy	980	991	1,142	1,201	1,262	1,372
Imports, f.o.b.	(-2,957)	(-2,532)	(-2,340)	(-2,297)	(-2,216)	(-2,442)
Energy	-340	-341	-202	-206	-233	-205
Non-energy	-2,617	-2,190	-2,138	-2,091	-1,983	-2,236
Nonfactor services (net)	284	335	286	330	462	513
Of which: Tourism receipts	(449)	(491)	(414)	(435)	(517)	(586)
Transfers (net)	61	-80	-54	-57	-2	-32
Of which:						
Receipts from workers' remittances	(309)	(266)	(308)	(284)	(352)	(347)
Interest on external debt	(-237)	(-253)	(-277)	(-265)	(-272)	(-297)
Capital account	670	433	432	235	193	366
Grants	28	36	35	28	29	27
Direct and portfolio investment (net)	201	137	132	74	78	86
Medium- and long-term borrowing (net)	320	248	177	31	46	253
Disbursements	(685)	(641)	(644)	(540)	(555)	(776)
Amortization	(365)	(393)	(467)	(-509)	(510)	(522)
Short-term capital	121	5	67	—	68	—
Overall surplus or deficit (-)	-184	-147	-190	95	117	77
Changes in net reserves (increase -)	184	147	190	-95	-117	-77
Use of Fund resources	—	—	150	41	41	47
Other assets, net (increase -)	184	147	40	-136	-158	-123
Memorandum items:						
Current account deficit (-) (in percent of GNP)	-10.8	-7.1	-8.0	5.8	-1.4	-3.8
Gross reserves (in months of imports)	1.7	1.0	1.3	1.8	2.0	2.5
Debt service ratio	19.5	21.6	27.9	27.0	26.2	26.4

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

1/ EBS/87/200.

identified commitments. Taking into account scheduled amortization payments, net medium- and long-term borrowing would reach SDR 253 million, against a 1987 outturn of only SDR 46 million. The ratio of debt service payments to exports of goods and services is expected to stabilize in 1988 at 26.4 percent. The debt to GDP ratio, however, is projected to increase marginally in 1988 to about 61 percent. In view of the relatively low level of reserves and the strong seasonality pattern, the Tunisian authorities have decided to target for 1988 another overall balance of payments surplus in the amount of SDR 77 million.

Exchange rate policy will continue to be administered flexibly in 1988 as the value of the dinar will be adjusted against the basket of currencies to which it is linked in order to at least maintain the real effective exchange rate at the level of end-1987. The authorities have indicated that they would consider additional exchange rate action should their external objectives appear not to be within reach and the balance of payments come under pressure.

The authorities have succeeded in slowing down the rapid rate of debt accumulation in the context of the adjustment program, and are poised to reverse the trend after 1988. They have decided to strengthen debt-management policy further with the goals of reducing the country's debt burden and controlling the overall exchange rate risk. As a first step in this direction, with the active collaboration of several departments of the public administration, a monitoring unit charged with centralizing the data available on the debt structure is being constituted and is expected to be operational shortly.

In view of recent losses related to the exchange rate movements, the Tunisian authorities have decided to strengthen the system for hedging against exchange rate risk. The Central Bank will change the method of pricing of its forward contracts so as to take into full account the expected relative movement of the foreign currencies against the dinar, as indicated by the differential in interest rates on foreign currencies and the domestic money market interest rate. 1/ The Central Bank has also decided to offer renewable foreign exchange option contracts, with a maturity of up to one year. The pricing of these option contracts will also be based on the interest differentials. In the future, these instruments will be made available for certain types of financial transactions, in particular the servicing of foreign debt. For the term cover of commercial transactions, the authorities will seek a balance of the supply and demand of foreign currency at term from market participants through the use of the pricing mechanism. They do not envisage any loss for the Central Bank in its management of these

---

1/ The money market rate is determined by supply and demand conditions; money market operations of the Central Bank, however, have a significant weight in its determination. The spread between the eurodollar rate and the Tunisian money market rate at present is some 2.5 percent or broadly in line with the projected inflation differential.

instruments. It is also expected that commercial banks and other financial institutions could progressively be associated with the management of these financial instruments.

In the case of rapid and unexpected shifts in exchange rates that lead to liquidity problems for otherwise financially sound enterprises, the authorities will ensure that the banking system may extend credit through normal channels at prevailing interest rates. It is the intention of the Central Bank to provide liquidity, if necessary, to the commercial banks that extend credit for this purpose at the prevailing money market rate. 1/

The existing fund for the exchange rate risk guarantee extended to development banks has proved very expensive for the Government. Accordingly, the authorities have decided to discontinue the extension of guarantees after August 15, 1988. The fund, however, will continue to finance the losses that will be realized on liabilities already assumed.

A new exchange risk cover scheme available to banks only will be established to provide guarantees for external credit lines that are contracted at the instruction of the Government and for balance of payments support. The authorities will endeavor to ensure that the guarantee will be provided essentially for external resources mobilized in the context of bilateral and multilateral cooperation. They intend to rely mainly on concessional loans channeled through development banks. The scheme will be managed by the Central Bank and will be financed by the proceeds of the differential between the interest rate on the external loans and the Tunisian money market rate. Any additional losses would be covered by the general revenue of the Central Bank. The authorities envisage the new scheme as a temporary mechanism to be phased out in the medium term. The structure of the loans admitted to the scheme and the overall annual limit of the guarantee accorded on such loans will be discussed with the Fund staff during the reviews of the program. The first review will also focus on the modalities of this scheme with a view to minimize any distortive effects and to ensure its self-financing character.

4. Trade and price liberalization

In January 1988, the authorities liberalized imports of capital goods, with the exception of goods produced by domestic infant industries or imported by weakly integrated ones. This followed the liberalization in 1986-87 of other imports serving as inputs for domestic production (raw materials, spare parts, and semifinished products). The liberalization of imports remaining subject to prior authorization, particularly consumer goods, will proceed gradually but steadily, and by end-June 1989 the ratio of freely imported goods to total imports will have increased from the present 53 percent to

---

1/ As noted above, access to central bank liquidity outside of the biweekly intervention would normally carry a penalty rate.

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.	Mar. 1/ Prog.	June 2/ Prog.	Sept. Prog.	Dec. Prog.
A. Performance criteria			(In millions of dinars)			
1. Domestic credit	4600	4551	4692	4796	4872	4999
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 3/	64 3/	192 3/	220
4. Official borrowing abroad 4/						
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	2549	...	605	1252	1903	2716
3. Total expenditure and lending (excluding debt amortization)	-2836	...	-652	-1451	2109	3066
4. Credit by monetary system to selected public enterprises 5/	...	...	...	...	...	...
5. Credit by development banks 5/						
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.

performance criteria and indicative targets. Each of the reviews will include an assessment of the progress made in the various structural reforms, with particular attention given to exchange rate policy, tax reform, financial sector reform, and the liberalization of prices and foreign trade. In addition, the first review will specifically examine the restructuring program for the public enterprise sector.

As shown in Table 2, purchases during the arrangement are presently proposed to be phased in 15 equal quarterly amounts. In view of the recent Board decision on the Extended Fund Facility and Policy on Enlarged Access (June 6, 1988), the proposed phasing will be reconsidered during the first review of the arrangement and if requested by the authorities, a shift to six-monthly purchases would be considered. In the latter case, performance criteria would also be established on a six-monthly basis, and the timing of reviews would be reassessed.

V. Staff Appraisal

Performance under the 1986-87 stand-by arrangement was in many respects better than originally envisaged. After stagnating in 1986 because of drought conditions and the impact of the severe drop in terms of trade, real growth in 1987 exceeded the target, the rate of inflation was in line with projections, and the target for net foreign reserves was exceeded. Helped by the resources shift toward nontraditional exports, the external current account deficit declined sharply. The favorable outturn in 1987 was due partly to temporary factors, but to an important extent it reflected strict demand-management policies and timely implementation of structural policies, including the flexible use of exchange rate policy.

Overall, the authorities have successfully implemented the first stage of the structural and financial adjustment process. Despite the progress made, however, Tunisia still faces the challenge of correcting remaining financial imbalances, while encouraging further structural adjustment, which will induce more rapid and sustained growth. In the period immediately ahead, the authorities' task of securing growth and employment is made more difficult by the reversal of most of the favorable temporary factors that influenced 1987. At the same time, the authorities are concerned that real investment dropped significantly more than anticipated in 1987, thus slowing the rate of employment creation and exacerbating unemployment. Nevertheless, the authorities are convinced that sustainable economic growth and the necessary increase in employment will be achieved only in the context of a sustained drive to open up the economy to foreign competition and to modernize the productive system.

The medium-term program, in support of which Tunisia has requested an extended arrangement, envisages a shift in the relative emphasis of the adjustment process toward strengthening the structural components, while continuing cautious demand-management policies. The 1988-91

program, which has been developed by the Tunisian authorities in close collaboration with the staffs of the Fund and of the World Bank, aims at achieving an average annual rate of growth of 3.5 percent, reducing the rate of inflation to 5 percent, lowering the external current account deficit to 2 percent of GDP, and generating balance of payments surpluses averaging SDR 60 million per year. Thus, at the end of the program period, the external debt/GDP ratio will have been reduced significantly, adequate reserves will have been accumulated, and balance of payments viability will have been consolidated in the face of the continuing structural deterioration in the energy trade balance. In support of these objectives, the authorities intend to reduce further the overall central government deficit by some 2 percentage points in relation to GDP, to continue the pursuit of a prudent monetary and credit policy, and to intensify their efforts toward increased efficiency of production and exports. Thus, the program aims at accelerating the process of price and trade liberalization, strengthening the financial system, restructuring the public enterprise sector, and introducing a comprehensive tax reform.

The government finance situation will remain tight during the program period owing to the authorities' choice to shift more resources toward the private sector of the economy and to some uncertainties regarding the impact of the tax reform. Great care will need to be exercised that any unexpected revenue shortfalls emanating from the tax reform are promptly corrected. Given the projected decline in the revenue to GDP ratio, expenditure restraint will play a critical role in the achievement of the authorities' target. In particular, the program envisages a decline in transfers and subsidies in real terms, as well as a reduction in transfers to public enterprises. While the financial operations of the public enterprise sector should improve as the reform process gains strength, the financial restructuring of major public enterprises could have adverse budgetary implications that will need to be monitored carefully within the overall budgetary framework. Considerable efforts will also be required in meeting the programmed limits on consumer subsidies. On the basis of present projections, significant increases in the prices of socially sensitive products are necessary and will need to be implemented in a timely fashion. The targeted reduction in the role of the central government sector, and in particular the relative reduction in consumer subsidies, may initially affect certain low income groups. However, the Goverment's strategy will result in higher levels of private sector investment and activity that should over time more than compensate for any negative effects of the adjustment measures.

Interest rate policy has been already liberalized to a significant extent in the context of the recent stand-by arrangement. One of the key elements of the proposed program is to take the process further toward a market-oriented financial system. The timing and modalities of specific measures to reduce the remaining segmentation of the credit markets and to introduce additional monetary instruments will be determined with the help of technical assistance from the Fund.

The flexible exchange rate policy pursued by the authorities since 1986 has made an important contribution to the adjustment in the external sector. The authorities have reaffirmed their determination to continue ensuring the external competitiveness of the Tunisian economy. Exchange rate policy will need to be kept under continuous review in light of the medium-term objectives of the balance of payments, particularly the ambitious export growth targets and the progress to be made in the liberalization program. During the program period the authorities intend to study measures to improve the efficiency of the allocation of foreign exchange in the economy. The staff considers the exchange system an area in which it would be desirable to make further progress over the medium term.

The authorities have decided to introduce on a temporary and limited basis exchange rate guarantees on certain external debt contracted by banks at the direction of the Government. They expect this scheme to be self-financing through a differential between foreign, mostly concessional, interest rates and the domestic money market rate. The staff welcomes that no new guarantees will be extended under the existing arrangement, which on the basis of information available to the staff gave rise to a multiple currency practice; whether this multiple currency practice will exist in the future will depend upon the way in which the authorities arrange to cover any further losses under the scheme. The staff believes that the new scheme will need to be carefully devised so as to limit its distortive effects and to ensure to the fullest extent possible that it is self financed. Its implementation will need to be monitored closely so as to avoid significant losses and to avoid introducing any financing features which, as exchange subsidies, could give rise to a multiple currency practice. In any case, it would be desirable to phase out such exchange rate guarantees at an early date. The modalities of this scheme will be addressed during the first review under the proposed extended arrangement.

The opening of the economy and the increased role assigned to the private sector in the structural adjustment process are essential for the success of the program. Pressures will undoubtedly arise against some elements of the policy package, especially when overly protected sectors are increasingly exposed to foreign competition. The staff welcomes the authorities' firm intention to adhere to the path of liberalization in order to assure the confidence of the private sector in the reform process and ultimately its success.

In conclusion, the staff is confident that the policies proposed in the program are fully adequate to achieve the authorities' objectives for 1988 and the medium term. Moreover, the authorities' good track record in implementing the 1986-87 program provides a strong indication that the policies outlined in the program will be implemented in a timely manner. The authorities' program for which they request an extended arrangement, therefore, deserves the support of the Fund and of the international financial community.

VI. Proposed Decision

In view of the foregoing, the following draft decision is proposed for adoption by the Executive Board:

Extended Arrangement

1. The Government of Tunisia has requested an extended arrangement in an amount equivalent to SDR 207.3 million for a period of 36 months from 1988 to 1991.

2. The Fund approves the extended arrangement set forth in EBS/88/119.

3. The Fund waives the limitation in Article V, Section 3(b)(iii)).

Tunisia - Extended Arrangement

Attached hereto is a letter with an annexed memorandum dated June 16, 1988 from the Governor of the Central Bank of Tunisia, the Minister of Planning, and the Minister of Finance requesting an extended arrangement and setting forth:

(a) the objectives and policies that the authorities of Tunisia intend to pursue for the period of this extended arrangement;

(b) the policies and measures that the authorities of Tunisia intend to pursue for the first year of this extended arrangement; and

(c) understandings of Tunisia with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Tunisia will pursue for the second and third years of this extended arrangement.

To support these objectives and policies the International Monetary Fund grants this extended arrangement in accordance with the following provisions:

1. For a period of three years from 1988, Tunisia will have the right to make purchases from the Fund in an amount equivalent to SDR 207.3 million, subject to Paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Until August 15, 1989, purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 63.80 million, provided that purchases shall not exceed the equivalent of SDR 15.95 million until November 15, 1988, the equivalent of SDR 31.90 million until March 15, 1989, and the equivalent of SDR 47.85 million until May 15, 1989.

(b) Until August 15, 1990, purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 127.6 million.

(c) The right of Tunisia to make purchases during the second and third years shall be subject to such phasing as shall be determined.

3. Purchases under this extended arrangement shall be made from ordinary resources until the outstanding use of ordinary resources in the upper credit tranches and under the Extended Facility equals 140 percent of Tunisia's quota in the Fund of SDR 138.2 million. Thereafter, purchases shall be made from borrowed resources, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Tunisia will not make purchases under this extended arrangement:

(a) during any period in which the data at the end of the preceding period indicate that

(i) the limit on domestic credit of the banking system, or

(ii) the limit on net claims on the Government by the banking system, or

(iii) the target for net foreign assets of the Bank of Tunisia, or

(iv) the limits on the contracting or guaranteeing by the Government of nonconcessional external debt,

referred to in Paragraph 35 of the memorandum on the economic and financial policies of Tunisia annexed to attached letter and in the table annexed to that memorandum is not observed; or

(b) if Tunisia accumulates any new external payments arrears; or

(c) after March 15, 1989, August 15, 1989, March 15, 1990, August 15, 1990, and March 15, 1991, respectively, until the reviews contemplated in Paragraph 36 of the Memorandum on the Economic and Financial Policies of Tunisia annexed to the attached letter have been completed and suitable performance criteria have been established or after such performance criteria have been established, while they are not being observed; or

(d) if Tunisia

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements that are inconsistent with Article VIII, or

(iv) imposes or intensifies restrictions on imports for balance of payments reasons.

When Tunisia is prevented from purchasing under this extended arrangement because of this Paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Tunisia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Tunisia will not make purchases under this extended arrangement during any period in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action with respect to a noncomplying purchase.

6. Tunisia's right to engage in the transactions covered by this extended arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Tunisia. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this Paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Tunisia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this extended arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Tunisia, the Fund agrees to provide them at the time of the purchase.

8. The value date for purchases under this extended arrangement involving borrowed resources will be determined in accordance with Rule G-4(b) of the Fund's Rules and Regulations. Tunisia will consult the Fund on the timing of purchases involving borrowed resources in accordance with Rule G-4(d).

9. Tunisia shall pay a charge for this extended arrangement in accordance with the decisions of the Fund.

10. (a) Tunisia shall repurchase the outstanding amount of its currency that results from a purchase under this extended arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Tunisia's balance of payments and reserve position improves.

(b) Any reductions in Tunisia's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this extended arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that the repurchase will be completed not later than seven years from the date of purchase.

11. During the period of the extended arrangement Tunisia shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Tunisia or of representatives of Tunisia to the Fund. Tunisia shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Tunisia in achieving the objectives and policies set forth in the attached letter and its annexed memorandum.

12. In accordance with the last paragraph of the attached letter, Tunisia will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultations because any of the performance criteria in Paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Tunisia has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Tunisia's balance of payments policies.

June 16, 1988

Dear Mr. Camdessus:

Since the second half of 1986, Tunisia has implemented a structural adjustment program aimed at securing an adequate rate of growth and employment while gradually achieving a viable balance of payments position. In support of these aims, Tunisia has sharply strengthened its external competitiveness and accelerated the process of liberalizing the economy in the context of restrained demand-management policies.

As noted in our letter of March 7, 1988, the objectives of the program for 1987 in terms of growth, inflation, and the balance of payments have been met and even exceeded, owing to the combination of favorable factors and the positive effects of the structural adjustment policies. However, job creation was less than foreseen, aggravating the level of unemployment, which is currently estimated at 15 percent.

Unfavorable exogenous developments in 1988, including notably the persistent drought and the invasion of locusts, will not allow a complete consolidation of the progress achieved in 1987 in correcting economic and financial imbalances.

Nevertheless, Tunisia remains determined to continue the process of adjustment. In that context, it has reviewed the economic program for the remaining period of the Seventh Development Plan ending in 1991.

In view of the favorable results in 1987, it has been possible to strengthen the external objectives by reducing the current account deficit of the balance of payments to 2.3 percent of GDP by 1991, compared with 3 percent foreseen in the Plan, to maintain the expected real rate of growth at 3.5 percent, roughly in line with the Plan objectives, and to place additional emphasis on promoting employment opportunities in view of the worrisome unemployment situation. The attached economic memorandum outlines the specific steps the Government intends to take until 1991 in support of these objectives. The program is in support of the continuation of the process already initiated of liberalizing prices, investment, interest rates, and imports as well as an increase in the role of the private sector in production, marketing, and investment activities. At the same time, the program emphasizes the continued pursuit of cautious demand-management policies as well as policies to safeguard the external competitiveness of the economy.

For this we would like to obtain the support of the International Monetary Fund in the form of a three-year extended arrangement in an amount equivalent to SDR 207.3 million to enable us to carry out the program in accordance with the established schedule and without recourse to temporary precautionary measures.

The Government of Tunisia believes that the policies described in the memorandum should be adequate to achieve the objectives of the program. It will take any additional measures necessary to achieve the objectives laid down, and it will of course consult the Fund during the program period in accordance with the institution's policies.

Ismail Khelil	Mohamed Ghannouchi	Nouri Zorgati
Governor	Minister of Planning	Minister of Finance
Central Bank of Tunisia	Ministry of Planning	Ministry of Finance

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Memorandum on the Economic and Financial Policies of Tunisia During the Period of the 1988-1991 Structural Adjustment Program

1. Since the second half of 1986, Tunisia has been firmly implementing a program of economic recovery and liberalization. This adjustment program, which has been supported since November 4, 1986 by a stand-by arrangement from the Fund, has consisted of a policy package including strict demand management, an improvement in external competitiveness (specifically, a real depreciation of the effective exchange rate by 25 percent between late 1985 and late 1987), and a gradual liberalization (in particular of investment, imports, and prices) aimed at improving the efficiency and the growth potential of the economy. The initial results of this strategy have been encouraging. After experiencing a drought and a deterioration in the terms of trade in 1986, the Tunisian economy showed a considerable recovery in 1987, recording strong real growth in the context of a significant reduction in inflation and financial imbalances. Real GDP growth in 1987 was 5.8 percent; the current account deficit was reduced from 8.0 percent of GDP in 1986 to 1.4 percent in 1987; and the consolidated deficit of the Central Government (on a commitment basis) declined from 5.7 percent of GDP in 1986 to 3.6 percent in 1987.

2. However, Tunisia's economic recovery in 1987 was uneven. The growth of GDP resulted mainly from the strong performance of agriculture, tourism, and other exporting sectors, while activity in the rest of the economy was seriously affected by sluggish domestic demand. Stagnating private consumption (in real terms) reflected both the success of measures to encourage financial savings, and the impact of incomes policy and other demand-management instruments. The decline in investment during the same year (13 percent in real terms) stemmed not only from the factors mentioned above, but also from lower investment by the public sector and a wait-and-see attitude on the part of private investors.

3. A number of factors reduced the current account deficit significantly in 1987. The abundant agricultural harvest and lower international prices led to a decline in net imports of agricultural and food products. The deterioration in real terms of the trade surplus in petroleum products was more than offset in 1987 by the rise in international prices. Also, a major structural adjustment that followed the depreciation of the exchange rate was reflected in an 18 percent real growth in exports of non-energy goods and services. In addition, the impact of the exchange rate depreciation and the change in importers' stockbuilding behavior (owing to the liberalization of imports) explained in part the decline in imports despite their gradual liberalization. Nonetheless, the exceptionally low level of imports reflected the especially depressed levels of domestic demand and, in particular, of investment.

4. Fiscal performance in 1987 was better than programmed, owing essentially to the control of budgetary expenditures. Direct investment expenditures related to external financing were thus lower than expected, which was reflected in lower drawings on external lines of credit tied to projects. Provisional results also indicate savings on current transfers to households, on interest payments (especially abroad), and on expenditures on goods and services, while the wage bill and consumer subsidies were in line with the program objectives. The strong growth performance was not reflected fully in fiscal revenue, however, because agriculture, tourism, and some exporting sectors are not heavily taxed. In fact, government revenue was affected slightly by low transfers by the state oil company (ETAP), and weak domestic demand and imports. The additional national income generated by growth in 1987 was thus largely channeled into private sector savings, with this sector contributing relatively more than the public sector to the reduction in the external imbalances.

5. The results obtained in 1987 indicate that the economic and financial policies are on the right track to bring about growth through structural adjustment. The latter is all the more necessary, given the importance of replacing the oil sector as a driving force to achieve sustained growth. While seeking to make rapid progress in this direction, the Tunisian Government believes that the inherent delays in the redeployment of the productive system, the significant real drop in the purchasing power of households in recent years, and the persistently serious unemployment situation call for caution in the management of domestic demand so as to avoid triggering an undesirable recession in certain sectors. Consolidation of the external adjustment should be sought chiefly by the diversification and steady growth of exports, as well as by sustained fiscal adjustment, which would make it possible to finance the investment required to restructure the productive system without jeopardizing the balance of payments.

Macroeconomic Framework and Objectives for the 1988-1991 Period

6. In accordance with the orientation of these policies and in light of the encouraging results in 1987, the authorities have set the following macroeconomic objectives for the remaining period of the Plan (1988-91):

(i) to achieve a real average growth of at least 3.5 percent, which is an ambitious objective in view of the required restructuring of the productive system;

(ii) to reduce price inflation to about 5 percent by 1991 and to the average level projected for Tunisia's trading partners afterward, taking into account the price liberalization process and the required adjustments in administered prices and public tariffs in the coming years;

(iii) to reduce the central government consolidated deficit (on a commitment basis) to 2.3 percent of GDP by 1991, despite the expected drop in oil revenues;

(iv) to reduce the current account deficit to 2.3 percent of GDP by 1991, after the deterioration to 3.8 percent in 1988 (attributable mainly to poor results in agriculture); this is an ambitious objective, given the investment effort and the rapid deterioration in the energy trade balance foreseen for the coming years.

7. During the 1988-91 period, private consumption is projected to grow at an annual average rate of 2.9 percent (in real terms)--or significantly less than the growth of GDP--which, combined with the reduction in the government deficit, should boost national savings from 17.5 percent of GDP in 1988 to 21.5 percent in 1991. This would make it possible to finance a significant increase in investment (5.8 percent annual average in constant prices) in a manner compatible with the external adjustment objectives, which would be achieved through real average growth of 6.8 percent in nonenergy goods exports and 6.2 percent in nonenergy goods imports. The growth projection for exports is based on assumptions of increases in the production capacity and in productivity, and the preservation of external competitiveness. The agriculture, manufacturing, and services (especially tourism) sectors are expected to be the main contributors to GDP growth. The relative weight of other sectors in the economy (particularly oil, mining, and public services) should decrease gradually as a result of the redeployment of resources toward the tradable goods sector. Reflecting this restructuring, the ratio of exports of nonenergy goods and services to GDP should increase from 26 percent in 1986 to 33 percent in 1991, and the private sector should account for more than half (52 percent) of total investment during the 1988-91 period, compared with 44 percent in 1986-87.

8. In accordance with this strategy of structural adjustment, the weight of the central government sector in the economy will gradually decrease: thus, budgetary revenue (including grants) would decline from 31.9 percent of GDP in 1987 to 29.2 percent in 1991, while budgetary expenditures (excluding amortization of debt principal) is expected to drop from 35.5 percent of GDP in 1987 to 31.5 percent in 1991. The more rapid decline in expenditures, combined with a reduction in the deficit of the social security system, should make it possible to bring the central government consolidated deficit from 4.1 percent in 1988 to 3.5 percent in 1989, 2.9 percent in 1990 and 2.3 percent in 1991. While tax revenue (excluding social security contributions) should stabilize at about 20.5 percent of GDP, nontax revenue would decrease, primarily as a result of the decline in oil revenue, which is expected to drop by 1.6 percentage points of GDP between 1987 and 1991.

9. The implementation of the structural and macroeconomic adjustment program will lead to a consolidation of the balance of payments viability and to an improvement in the external debt profile. The

temporary deterioration in the current account deficit expected in 1988 must be attributed chiefly to exogenous factors. Thereafter, the deficit should drop steadily despite the following adverse factors: (i) the inevitable decline in oil revenue; (ii) the investment cycle required to restructure the productive system; and (iii) the increase in external interest payments. The current account deficit is thus expected to rise to 3.8 percent of GDP in 1988 before dropping back to approximately 2.3 percent by 1991. However, when the trade balance in petroleum products is excluded, the projections for the current account deficit show a decrease from 4.9 percent of GDP in 1988 to 2.0 percent in 1991, indicating a significant structural adjustment. After 1991, the authorities will seek as a minimum to maintain the current account deficit at a sustainable level. The deficit would be financed during the program period by net capital inflows that would allow a continued increase in gross reserves, which should increase from the equivalent of two months of imports in 1987 to the equivalent of three months by 1991. After relative stability in 1988-89, the debt service ratio (in terms of total exports of goods and services) should peak at close to 29 percent in 1990, before dropping rapidly in the 1990s. The outstanding debt would thus be reduced from 58 percent of GDP in 1987 to approximately 54 percent in 1991.

Financial and Structural Policies for the 1988-91 Period

10. To achieve the medium-term objectives, the authorities' strategy focuses on the promotion of private initiative and rigorous management of public-sector resources by means of the following structural and financial policies.

11. As indicated above, the improvement in central government finances will result from a moderation of expenditures and an effort to stabilize tax revenue in relation to GDP, in a manner compatible with the reform of the incentive framework. During the program period, the average annual growth of the wage bill might reach 7 percent because of the revaluation of the productivity premium in two stages in 1988-89, and increases in the number of civil servants, which will not exceed 2 percent per year on average. Subsidies and transfers are projected to increase by 5.5 percent on average, with a reduction in real terms in the expenditures of the Caisse Générale de Compensation (which should drop from 2.3 percent of GDP in 1987 to 1.6 percent in 1991). Expenditures on goods and services would not grow in real terms. The small amounts of existing domestic arrears will be eliminated in 1988 and there will be no emergence of new domestic arrears during the program period. Capital expenditures and net government lending are expected to grow at an average annual rate of about 6 percent. The authorities have undertaken a tax reform, to be continued during the program period, that seeks to establish a simple and flexible tax structure while streamlining the tax incentives granted to the private sector. The impact of the introduction of the value-added tax (VAT) as of July 1, 1988 (followed by an extension of the base to the wholesale trade on

January 1, 1989) will be assessed by the authorities, who will adjust the rates and coverage in 1989, if necessary, to compensate for any shortfall in yield, given the objective of reducing the domestic excise taxes. Similarly, the objective of reducing the average level of customs duties will be achieved in such a way as to avoid a revenue shortfall for the Government, taking into account the progress made in this area in 1986-87. The authorities are also preparing the introduction of a single tax on individual income in January 1989 (applicable to 1988 incomes) and a reform of corporate profit taxation in 1990.

12. Interest rate flexibility will be used to regulate credit to the private sector and contribute to reducing inflationary pressures. The monetary authorities will seek to influence interest rates and the liquidity of the banking and financial system through intervention in the money market. In addition, they will seek to reduce the distortions in the interest rate structure and, consequently, the segmentation of the credit market by gradually eliminating the gap between preferential interest rates and the money market rate, and phasing out the service tax (TPS) and parafiscal levies on interest charges. Moreover, the authorities plan to introduce treasury bills on the money market, which would have a competitive interest rate and maturity structure and could be traded on a secondary market open to the public. The yield of these bills would help determine the general interest rate level, and they could gradually replace equipment bonds as a means of financing for the Government. In light of the progress achieved in the level of competition among credit institutions, the authorities are considering the gradual removal of the ceiling on lending rates. All of these issues will be examined in a study to be conducted with Fund technical assistance over the next few months, so that operational decisions may be implemented beginning in 1989.

13. Exchange rate flexibility will be guided by the need to maintain external competitiveness and to promote structural adjustment. The real effective exchange rate will be maintained at least at its end-1987 level. In addition, the authorities would consider exchange rate adjustments, should the balance of payments or foreign exchange reserves come under pressure. The authorities are also working, in collaboration with the Fund, on developing new instruments to promote an efficient allocation of foreign exchange, and to help develop an interbank foreign exchange market. It is in this context that the authorities are planning to introduce market mechanisms that will make it possible to improve the current exchange risk cover schemes, and are considering more flexibility in the norms governing the surrender of foreign exchange export proceeds.

14. The employment policy is geared toward favoring the restructuring of the economy, which would induce job creation, especially in the tradables sector. However, in order to reduce certain rigidities in the labor market, the authorities have developed a number of incentives for hiring young people and job creation schemes in the regions. The budgetary cost of these various initiatives will be limited. In

particular, the four-year program for the creation of 100,000 jobs (for the unskilled unemployed) will be financed essentially with concessional foreign aid. The objectives of these initiatives are not to place job seekers more or less permanently on the public sector payroll, but to create genuine employment opportunities in productive sectors.

15. The incomes policy will remain cautious, reflecting progress in reducing inflation and unemployment. The authorities will endeavor to avoid any slippage in wage policy that would harm external competitiveness and hamper job creation by raising production costs. To this end, the real increase in the wage index will remain, on average, below that of national income during the program period, and raises will continue to be linked to productivity gains. Social transfers to households will be subject to the same considerations, given the need to limit social charges borne by businesses, and to preserve a sound financial balance for the social security system.

16. Pricing policy will be guided by the desire to promote growth in supply while ensuring the efficient use of resources. The authorities will therefore continue to adjust the prices of agricultural inputs and products to reflect developments in costs. Similarly, regular adjustments will be made in public tariffs, consistent with the objectives of public enterprise reform. In accordance with the objectives of the Seventh Plan, and while seeking to reduce the expenditures of the Caisse Générale de Compensation by 5 percent annually during the program period, the authorities will undertake to limit these expenditures to a maximum of D 185 million per year. Moreover, the liberalization of industrial producer prices will be continued, with a view to increasing the share of the relevant goods to at least 75 percent of manufacturing production by end-January 1991, compared with 55 percent at end-January 1988 (in accordance with the schedule in Table 2 attached). Thus, by 1991, all industrial prices will be free of control at the production stage, except for certain strategic or sensitive products that will continue to be controlled by the Government (specifically, petroleum products, water, electricity, and cereal derivatives). The process will be extended to the distribution sector, which will also be deregulated with a view to improving competition in this sector. The authorities anticipate at this stage that they will be able to free the distribution margins on commodities accounting for at least 50 percent of manufacturing production by end-January 1991 (an annual schedule is provided in Table 2). By monitoring the progress made in improving the competitive environment in the distribution sector, the authorities will be able to speed up, insofar as possible, the further liberalization of these margins.

17. The program of foreign trade liberalization will be continued, in order to help production management in enterprises using imported inputs, and to stimulate productivity gains and improvements in the quality of local production through increased exposure to foreign competition. Import liberalization will be continued with a view to freeing all imported goods during the program period, with the exception

of a restrictive list comprising luxury items and certain other goods. This would bring the share of freely imported goods to some 80 percent of total imports by 1991 (Table 2). In addition, the further gradual reduction of import duties will aim at achieving a relatively uniform rate of effective protection of about 25 percent by 1991.

18. The elaboration of a public enterprise reform is aimed at improving the management of those enterprises remaining in the public sector, and at divesting the rest by means of privatization or liquidation. Restructuring programs for enterprises remaining in the public sector will determine their strategy, including their activity portfolio, and will lay the foundations for autonomy in management on the basis of criteria of economic efficiency. This means, especially for enterprises in sheltered sectors, regular tariff adjustments aimed at achieving financial balance over time, including the self-financing required for their debt service and their investment program. Different financial restructuring options are currently being examined, in the context of the negotiation of a sectoral adjustment loan with the World Bank, in particular for the Compagnie des Phosphates de Gafsa (phosphates), the companies of the Groupe Chimique (phosphate derivatives) and the Société Nationale des Chemins de Fer (railroad). Special attention will be given to these issues during the first review of the program with the Fund.

19. The Tunisian authorities hope to obtain financial assistance from the international community in support of this structural adjustment program. The positive results obtained under the stand-by arrangement from the Fund demonstrate Tunisia's determination to achieve sustained growth that is compatible with a viable balance of payments position. In 1986-87, Tunisia obtained two sectoral adjustment loans totaling US$300 million from the World Bank in support of the agricultural policy reform and the industrial and foreign trade policy reforms. The negotiation of a new structural adjustment loan (SAL) for $150 million is about to be completed, and a sectoral adjustment loan for the reform of public enterprises is under discussion.

The Program for 1988

20. Consistent with the medium-term framework, the macroeconomic objectives for 1988 are:

(i) to achieve real positive growth of GDP (1 percent) despite serious problems of drought and locusts in the agricultural sector;

(ii) to contain inflation (measured by the average annual increase in the general consumer price index) at 6.5 percent (after 8.2 percent in 1987), taking into account the continued liberalization of prices and the required adjustment of certain administered prices and tariffs on public services, and in the context of a moderate upturn in domestic demand;

(iii) to limit the external current account deficit to 3.8 percent of GDP in 1988, despite a continued deterioration in the energy trade balance, and the impact of a poor agricultural harvest and the expected recovery in investment.

21. The Government's fiscal position will be much more difficult in 1988 than in 1987, reflecting an estimated revenue loss of some D 76 million stemming from various measures to reduce certain duties and taxes, including customs duties, the service tax (TPS) on interest charges, the taxation of income on securities, and registration fees. The expected shortfall does not allow for the possible impact of the introduction of the VAT in July 1988, as it is difficult to determine whether a related revenue shortfall will occur. Nonetheless, the authorities expect that any potential shortfall will be offset by the broadening of the tax base and the positive effect of the tax amnesty. In spite of the projected losses, total revenue is estimated to increase by 7 percent, taking into account new measures such as an increase in petroleum prices and in public tariffs, a special contribution by commercial banks to the Special Fund for Exchange and Interest Rate Risks and increases in certain excise taxes.

22. Total expenditure (including net lending) is estimated to increase by about 8 percent. After a four-year freeze, and taking into account the effect of promotions and recruitment, the planned increase of 10 percent in the wage bill reflects the revaluation of the productivity premium, the impact of which will be a 3 percent increase on average. The budget also includes an allocation of D 12 million to eliminate remaining domestic arrears and a 10 percent increase in the allowance for supplies so as to preclude any new domestic arrears. Consumer subsidies will be maintained at their 1987 levels, entailing a decline in real terms and requiring price increases for certain subsidized goods during the year. Expenditure forecasts for 1988 also include a total of D 34 million in current subsidies to public enterprises in the phosphates sector and a special payment of D 40 million from the Exchange and Interest Rate Risks Fund to development banks.

23. The central government consolidated deficit (including special funds and social security funds, and on a commitment basis) is thus estimated at D 350 million (4.1 percent of GDP). Net foreign financing is projected to increase sharply in 1988, on the basis of credit lines already in place, to D 237 million. Taking into account the expected level of nonbank domestic financing ("emprunts nationaux" and subscriptions of equipment bonds outside the banking system), bank financing of the central government consolidated deficit should be reduced from D 94 million in 1987 to D 50 million in 1988.

24. The serious problems facing the agricultural sector in 1988, due to the drought and the invasion of locusts, necessitate certain changes to government expenditure plans. Accordingly the authorities intend to submit a supplementary finance law for parliamentary approval before

July. The additional expenditure would relate to support of the small-scale livestock sector, the fight against the locusts, and the initiation of employment programs to offset in part the significant loss of employment opportunities in the agricultural sector estimated at the equivalent of 55,000 permanent jobs. The supplementary finance law under preparation estimates the expenditures involved at about D 30 million (equivalent to 0.4 percent of GDP). Of this amount, at least D 16 million would be financed by identified external grants and a national solidarity contribution. A strong effort is underway to ensure the financing of the remaining amount through additional grants and restraint on other government expenditure, in order to maintain the target of a central government consolidated deficit of D 350 million.

25. The rate of growth of broad money is projected at 9 percent, which is somewhat higher than that of domestic demand. Given the targeted increase in net foreign assets of D 85 million, domestic credit expansion should be limited to 8.7 percent. The bank financing of the consolidated deficit of the Central Government (D 50 million in 1988) would be consistent with a 9 percent expansion of credit to the rest of the economy, which is considered the minimum level required to sustain the investment effort needed for the restructuring of the economy.

26. In early 1988, the monetary authorities improved the operation of the money market by authorizing interbank transactions and the participation of nonbank financial institutions and certain enterprises. With a view to liberalizing further the financial system, the requirement of prior approval from the Central Bank for refinanceable credits or credits of over D 5 million has been eliminated. Moreover, in order to promote a revival of private investment, the service tax (TPS) on interest charges was reduced from 14 percent to 6 percent in November 1987, bringing down the cost of credit by 1.1 percentage points. After the reorganization of the money market in January 1988, periodic interventions by the Central Bank were limited to meeting some 20 percent of the liquidity needs expressed by the banks, ths rest being met through interbank transactions. The central bank intervention rate dropped slightly, from 9 1/2 percent in January to 9 5/16 percent in mid-April, as a result of the moderation in the rate of inflation over the past few months. The rates for interbank transactions fluctuated daily according to supply and demand conditions, remaining on average 1/8 of 1 point above the central bank intervention rate. The authorities will pursue an interest rate policy consistent with the objective of reducing inflation. Finally, as indicated above, the study to be conducted in 1988 with the technical assistance of the Fund will help in particular to prepare for the introduction of treasury bills.

27. The current account deficit is projected at SDR 289 million in 1988, or SDR 186 million higher than the actual 1987 figure. Notwithstanding excellent results in exports of manufactured goods and in tourism, the expected deterioration in the food and energy trade balances largely explains the increase in the deficit. The latter also reflects an increase in interest payments and the recovery of imports of

capital goods. Net capital inflows should total SDR 366 million, given the objective of increasing net foreign assets by SDR 77 million. Drawings on medium- and long-term borrowing should total SDR 776 million, of which SDR 540 million has already been contracted and the rest has been identified.

28. During 1988, the authorities will continue their flexible exchange rate policy with a view to keeping the real effective exchange rate at least at its end-1987 level and maintaining the competitiveness of the Tunisian economy. Moreover, the authorities will adopt an active foreign debt management policy with the goal of reducing the country's debt burden and its overall exchange risk. As a beginning, a monitoring unit will be constituted immediately, and will be responsible for centralizing the data available on the external debt structure (by creditor, by currency, and by interest rate and maturity terms).

29. In light of the strong volatility of currencies on foreign exchange markets, and given the flexible exchange rate policy pursued by Tunisia, the exchange risk cover scheme will be modified, so as to facilitate the assumption of exchange risks by the economic agents concerned, to limit to the maximum extent the cost to the Treasury, and to prepare the ground for applying a cover scheme based on market-determined instruments. On the basis of these principles, the Central Bank will continue to manage a forward foreign exchange market (up to a maturity of one year), and will offer renewable foreign exchange options (with a maximum maturity of 12 months), taking into account the differential in interest rates on foreign currencies and the dinar market interest rate, which is determined competitively by supply and demand conditions in the money market. In providing forward cover for commercial transactions, the Central Bank will seek to achieve balance among market participants. In case of rapid and unexpected shifts in exchange rates that lead to liquidity problems for financially sound businesses, the banking system may intervene through normal credit channels, with the possibility of refinancing at terms prevailing on the money market. The authorities will examine periodically with the Fund staff the operation of these instruments of cover, as well as the possibility of developing other short-term hedging instruments for foreign exchange risk, and ways of associating banks and other financial institutions with the management of this system.

30. Given the projected cost to the budget of the present Exchange Rate Guarantee Fund, the guarantee extended by this fund will be eliminated from August 15, 1988, except for the settlement of claims on loans contracted by development banks before that date. Thereafter, the Central Bank will put in place an exchange rate cover scheme for external credit lines that are contracted by banks at the instruction of the Government and in the context of balance of payments support. The authorities will endeavour to ensure that the bulk of these resources is mobilized in the context of bilateral and multilateral cooperation at concessional terms. This scheme, which is only of a temporary nature, will enable Tunisia to mobilize credit lines offered to the Government

to finance development while meeting present budgetary constraints. The scheme will be financed by the proceeds of the differential between the interest rate on the external loans and the Tunisian money market rate, as well as, if necessary, by central bank revenue. The overall annual limit on such loans and their composition will be identified in the context of each Economic Survey, and will be discussed with the Fund staff during the periodic program reviews.

31. In January 1988, the authorities liberalized imports of capital goods, following the liberalization in 1986-87 of raw materials, spare parts, and semi-finished products for all enterprises, with the exception of certain goods, specifically those produced by infant industries or imported by weakly integrated industries. The liberalization of import categories that remain subject to prior authorization, in particular all consumer goods, will be implemented gradually so as to stimulate the ability of relevant industries to adjust to foreign competition. The authorities will launch a further series of liberalization measures before the end of June 1989, raising the ratio of freely imported goods to total imports from the current 53 percent to 68 percent by end-June 1989.

32. The second stage of the customs tariff reform came into effect in January 1988, entailing reductions ranging from 1 to 9 percentage points, with a maximum tariff set at 43 percent and a minimum at 17 percent.

33. In January 1988, the authorities also liberalized producer prices for various manufactured goods, thereby raising the proportion of industrial products for which prices have been liberalized since 1986 to about 55 percent. A further list of goods is to be liberalized in July 1988, bringing this proportion to approximately 60 percent. The first stage in the liberalization of distribution markups, planned for July 1988, will affect products representing 10 percent of manufacturing production.

34. A number of public tariffs as well as petroleum product prices will be increased during 1988 in order to mobilize resources for public enterprises and the Government. Moreover, some prices subsidized by the Caisse Générale de Compensation will be adjusted, thus limiting the deficit of the Caisse to its 1987 level.

Performance Criteria and Program Reviews

35. In order to review progress made under the program, the following performance criteria have been established: (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; and (d) limits on external nonconcessional debt contracted or guaranteed by the Government with a maturity of less than 1 year, between 1 and 5 years,

and between 1 and 12 years. There will be no accumulation of external payments arrears by the Central Government during the program period. In addition, the authorities do not intend to impose or intensify restrictions on payments and transfers for current international transactions, or introduce or modify multiple currency practices, or conclude bilateral payments agreements which are inconsistent with Article VIII of the Fund's Articles of Agreement, or to impose or intensify restrictions on imports for balance of payments purposes. Moreover, the following indicative targets have been selected: (i) consolidated deficit of the Central Government; (ii) revenue and grants; (iii) total expenditures and net lending; (iv) bank credit to selected public enterprises; and (v) distribution of credit by the development banks.

36. Apart from the aforementioned performance criteria, there will be five program reviews with the Fund 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 to make further purchases under the stand-by arrangement 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 performance criteria and indicative targets. All the reviews will entail an assessment of the progress made in the structural reforms, with particular attention given to the liberalization of prices and foreign trade, tax reform, financial sector reform, and exchange rate policy. Finally, the first review will specifically examine the restructuring program for the public enterprise sector and its impact on the central government budget.

Table 1. Tunisia: Performance Criteria and Indicative Targets, December 1987-December 1988

	1987 Dec. Performance	1988 Mar. 1/	June 2/	Sept.	Dec.
A. Performance criteria		(In millions of dinars)			
1. Domestic credit	4600	4692	4796	4872	4999
2. Net credit to the Government	721	721	760	737	771
		(In millions of SDRs)			
3. Net foreign assets of the Central Bank	145	27 3/	64 3/	192 3/	220
4. Official borrowing abroad 4/					
a. 0-1 year (amount outstanding, excluding import-related credits)	...	120	120	120	120
b. New nonconcessional borrowing abroad (cumulative amounts since January 1, 1988)					
(i) 1-5 years	...	170	170	170	170
(ii) 1-12 years	...	450	450	450	450
5. External payments arrears (amount outstanding)	--	--	--	--	--
B. Indicative targets		(In millions of dinars)			
1. Consolidated budget deficit	-287	-47	-199	-206	-350
2. Total revenue and grants	2549	605	1252	1903	2716
3. Total expenditure and lending (excluding debt amortization)	-2836	-652	-1451	2109	3066
4. Credit by monetary system to selected public enterprises 5/	...	...	...	...	...
5. Credit by development banks 5/					
a. to selected public enterprises	...	...	...	...	...
b. to the rest of the economy	...	...	...	...	...

1/ As indicated in our letter of March 7, 1988.
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 indicated in our letter of March 7, 1988.
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.

Table 2. Tunisia: Summary of the Program to Liberalize Foreign Trade and Prices, 1988-1991

1. Price liberalization

a. Liberalization of producer prices for manufactured goods representing:

approximately	55 percent	of manufacturing production	in January 1988
"	60 percent	"	in July 1988
"	70 percent	"	in March 1989
"	75 percent	"	by January 1991

b. Liberalization of distribution markups for products representing:

approximately	10 percent	of the value of production	in July 1988
"	20 percent	"	in January 1989
"	35 percent	"	in January 1990
"	50 percent	"	in January 1991

2. Import liberalization

a. Imports of raw materials, semi-finished products and capital goods were liberalized in three stages (with exceptions relating to infant or weakly integrated industries) in January 1988.

b. Liberalization of all products, according to the following schedule:

approximately	53 percent	of imports (1987 base)	in January 1988
"	68 percent	"	in June 1989
"	75 percent	"	in June 1990
"	80 percent	"	in March 1991

TUNISIA--Relations with the Fund

(As of April 30, 1988)

I. Membership status

Date of membership: April 14, 1958
Status: 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)

	Millions of SDRs	Percent of quota
(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)

	1988	1989	1990	1991	1992	1993
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	18.25	15.85	14.84	13.79

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.

World Bank Activities and Strategies in Tunisia

Since 1962, the Bank has committed to Tunisia 76 loans and 10 IDA credits amounting to US$1,890 million and US$75.2 million (net of cancellations), respectively. As of March 31, 1988 the sector shares of the Bank group commitments were as follows: Agriculture, 28 per cent; industry, 26 per cent; transport, 16 per cent; urban infrastructure, 16 per cent; energy, 8 per cent; education, 4 per cent; health, 1 per cent; and technical assistance, 1 per cent. Bank lending at first emphasized support for long-term investments in infrastructure and social development, with increasing support in recent years for agriculture and industrial financing. Most recently, a US$150 million Industrial and Trade Policy Adjustment loan was approved on February 24, 1987, which would support the first phase of implementation of the Government's program of industrial and trade policy reforms, within the framework of a general macroeconomic restructuring program. Project implementation has been generally satisfactory and, in a number of sectors, important policy changes and institutional improvements have been achieved, and autonomous agencies have been created or strengthened to ensure the efficient management of the related sectors or subsectors.

The Bank's lending strategy in Tunisia aims at supporting the country's transition from a situation of reliance on petroleum exports to a sectorally balanced post-hydrocarbon era through appropriate changes in economic policies and programs, while taking measures to increase employment and target development to low-income groups. In support of the above, the overall objective of Bank lending is to emphasize projects which have a direct and rapid impact on production, employment, and exports (or import savings) and which minimize government net contributions. The focus of lending for agriculture and industry meets this objective. In addition to the above, proposed Bank lending would focus on improvement of public enterprise performance, conservation and development of energy resources, and continued support to the social sectors and operations targeted to low-income groups. For the latter, attention would be given to increased efficiency and cost-effectiveness of institutions and investments, and to linkages with directly productive sectors (e.g., education reforms stressing vocational training). The Bank envisages only marginal lending for basic economic infrastructure, focussed in areas where Bank guidance would still be useful, such as rural water supply and highways maintenance. In addition to the recent Agricultural Sector Adjustment Loan and the Industrial and Trade Policy Adjustment Loan, program lending would include a Structural Adjustment Loan to be considered by the Bank's Executive Board before the end of June 1988, a Public Enterprises Rehabilitation Loan to be negotiated before the end of 1988, and a second Agricultural Sector Adjustment Loan, while other lending includes loans for highways maintenance, forestry, housing finance/cadastre restructuring, and credit lines for small-scale industries and agriculture.

The Bank's economic and sector work will address the increasing

complexity of the macroeconomic and sector problems that Tunisia will face in the medium term, and continue to focus on strengthening the macroeconomic and sector base for the lending program. In particular, it will follow up on the implementation of the recommendations of the studies carried out in the context of sector and adjustment loans. The main specific tasks include: (a) a mid-term review of the implementation of the Government's VIIth plan; (b) an analysis of the pricing and incentive systems in the agricultural sector; (c) a review of the transport sector strategy; and (d) an analysis of the poverty situation and of the public expenditures in the social sector.

Bank-Fund cooperation has always been close, with participation of Fund staff in Bank economic and sector missions and close informal contacts in Washington and in the field.

Tunisia: World Bank Loans and Debt Service, 1984-90

(In millions of U.S. dollars)

	1984	1985	1986	1987 Est.	1988	1989 Proj.	1990	1991
Commitments	135.1	168.7	184.2	245.8	220.0	300.0	300.0	300
Investment projects	135.1	168.7	34.2	95.8	70.0	100.0	200.0	225
Sectoral adjustment loans	--	--	150.0	150.0	150.0	200.0	100.0	75
Agricultural sector adjustment loan	--	--	150.0	--	--	--	--	--
Industrial and trade policy adjustment loan	--	--	--	150.0	--	--	--	--
Structural adjustment loan	--	--	--	--	150.0	--	--	--
Public enterprise restructuring loan	--	--	--	--	--	100.0	--	--
Agricultural sector loan II	--	--	--	--	--	100.0	--	--
Education sector loan	--	--	--	--	--	--	100.0	--
Public enterprise restructuring loan II	--	--	--	--	--	--	--	75.0
Disbursements	88.0	110.8	169.3	179.9	285.0	356.2	290.5	285.5
Investment projects	88.0	110.8	119.3	107.9	107.0	166.2	160.5	165.5
Sectoral adjustment loans:	--	--	50.0	72.0	178.0	190.0	130.0	120.0
Agricultural sector adjustment loan	--	--	50.0	37.0	63.0	--	--	--
Industrial and trade policy adjustment loan	--	--	--	35.0	90.0	25.0	--	--
Structural adjustment loan	--	--	--	--	25.0	100.0	25.0	--
Public enterprise restructuring loan	--	--	--	--	--	25.0	40.0	35.0
Agricultural sector adjustment loan II	--	--	--	--	--	40.0	40.0	20.0
Education sector loan	--	--	--	--	--	--	25.0	45.0
Public enterprise restructuring loan II	--	--	--	--	--	--	--	20.0
Debt service	79.7	93.6	125.9	145.5	164.4	186.8	210.1	249.1
Amortization	42.2	52.5	65.0	76.3	86.8	95.6	101.3	128.0
Interest and charges	37.5	41.1	60.9	69.2	77.6	91.2	108.8	121.1

Source: Data provided by the World Bank.

Tunisia: Summary of Adjustment Program, July 1986-December 1991

Objectives and Measures	Timing of Measures

A. Objectives	1987	1988	1989	1990	1991
			Projections		
1. Annual growth of real GDP	5.8	0.9	5.1	4.3	3.7
2. External current account deficit (percent of GDP)	1.4	3.8	3.4	2.8	2.3
3. Gross official reserves (in months of imports)	2.0	2.5	3.0	2.9	2.8
4. External debt (including IMF; percent of GDP)	57.8	61.6	59.5	56.8	53.7
5. External debt service (percent of current receipts)	26.2	26.4	26.2	26.9	27.2

B. Measures	
1. Price liberalization	
a. Services.	Mostly free of administrative controls.
b. Agriculture.	
(1) Subsidized consumer goods.	Expenditure to be maintained unchanged in nominal terms in 1988 and thereafter.
(2) Subsidized inputs.	To be eliminated completely during program period in accordance with timetable agreed with the World Bank.
(3) Producer prices.	Mostly free of controls (80 percent). Remaining raised significantly in 1986-87 in agreement with World Bank. To be aligned with international levels according to formula agreed with the World Bank.
c. Manufactured goods.	
Approximately 55 percent	Liberalized by January 1988.
" 60 percent	To be liberalized by July 1988.
" 70 percent	To be liberalized by March 1989.
" 75 percent	To be liberalized by January 1991.
d. Distribution margins.	
Approximately 10 percent.	To be liberalized by July 1988
" 20 percent.	To be liberalized by January 1989
" 35 percent.	To be liberalized by January 1990
" 50 percent.	To be liberalized by January 1991
2. Public enterprises	
a. Reduction in controls and improvement of financial viability.	State control being limited to enterprises in which the participation of the Government is 50 percent or more (compared with 34 percent at present). The Government in August 1987 promulgated legislation authorizing the gradual sale of government shares to the private sector and this process has been initiated. A systematic review is under way with a view to improving the financial viability of those enterprises that are to remain in the public sector.
b. Additional measures.	The review of public enterprises and the privatization effort will be streamlined, and further recommendations and a quantified timetable will be drawn up in the context of the World Bank Public Enterprise Restructuring Loan (PERL).
3. Import liberalization	
a. Import liberalization.	
(1) Liberalization of imports of raw materials, semifinished goods, and investment goods.	Liberalized in three stages by January 1988 (with minor exceptions) taking the ratio of freely imported imports to total imports to 53 percent in 1988.
(2) Liberalization of remaining imports except certain goods (essential goods, luxury goods, and goods produced by infant industries) estimated at the equivalent of 20 percent of imports.	
Approximately 53 percent.	Liberalized by January 1988
" 68 percent.	To be liberalized by June 1989
" 75 percent.	To be liberalized by June 1990
" 80 percent.	To be liberalized by March 1991

Tunisia: Summary of Adjustment Program, July 1986-December 1991 (concluded)

Objectives and Measures	Timing of Measures
b. Tariff reform. Reform of import tariff to reduce effective protection to about 25 percent by 1991.	
(1) Reduction in maximum import duties to 41 percent and reduction in other rates by between 1 percent and 9 percent.	January 1988.
(2) Additional measures to achieve an average rate of tariff protection of 25 percent.	January 1991.
4. Exchange rate, exchange system, and external debt	
a. Maintenance of the real effective value of the dinar through periodic adjustment of the nominal value. Additional corrections if the balance of payments position requires.	To be implemented throughout program period.
b. Elimination of present system of granting exchange rate guarantees to development banks and establishment of new system to selectively grant guarantee on loans contracted at the direction of the Government.	August 15, 1988.
c. Limit nonconcessional external debt of 1-12- year maturity, with sublimits on that in maturity range of 1-5 years.	To be established annually.
d. Limit short-term debt (of maturity up to one year) excluding import-related credit.	To be established annually.
5. Public finance	
a. Limit 1988 central government deficit (on a commitment basis) to D 350 million (4.1 percent of GDP).	Budget announced.
b. Limit central government deficit to 3.5 percent of GDP in 1989, 2.9 percent in 1990, and 2.5 percent in 1991.	
c. Introduce VAT.	July 1988.
d. Unify schedular taxes.	With effects on income earned in 1988.
e. Reform corporate taxation.	With effects on income earned in 1988.
6. Credit and monetary policies	
a. Elimination of prior credit and refinancing approval by the Central Bank.	January 18, 1988.
b. Strengthening of reserve loss provisions.	January 18, 1988.
c. Strengthening of money market.	January 18, 1988.
d. Increase in interest rate on treasury bonds from 6.5 percent to some 8.5 percent to compensate for the elimination of their fiscal advantage.	January 1989.
e. Introduction of market for treasury bills.	Early 1989.
f. Elimination of differential between interest rate on money market and preferential credits by 1991. The first step will be the elimination of one third of the differential.	September 1989.

TUNISIA - Social Indicators

	1965	1973	1985	1985 North Africa 1/ and Middle East	1985 Latin America 1/
GNP per capita (in US$)	...	...	1,270	1,136	1,783
Population					
Total population	4,630	5,412	7,260	...	...
Urban population (% of total)	39.5	47.2	54.1	49.3	68.9
Growth rate					
Total	...	2.0	2.5	2.8	2.3
Urban	...	4.2	3.8	4.1	3.6
Birth rate (per 1000)	44.2	37.0	32.2	39.5	30.1
Death rate (per 1000)	16.7	12.6	9.1	10.4	7.7
Life expectancy	50.8	55.5	62.2	59.9	65.6
Population structure (% of total)					
Working age (15-64 years)	49.8	51.1	55.6	52.7	57.1
65 years and above	3.6	3.6	3.9	3.4	4.3
Food, health and nutrition					
Calorie intake (% of requirement)	96.5	107.7	120.9	117.5	109.3
Access to safe water (% of population)	...	49.0	63.0	71.3	66.3
Population per physician (thousands)	8.0	6.4	3.9	4.6	1.3
Infant mortality (per thousand)	146.5	118.2	79.4	94.0	56.1
Child death rate (per thousand)	30.0	23.9	7.6	12.1	4.3
Education					
Enrollment rates (in percent)					
Primary	91.0	100.0	113.0	93.5	107.3
Secondary	16.0	23.0	33.0	44.7	49.1
Pupils reaching grade 6 (in percent)	...	67.4	86.7	75.9	55.2
Labor force					
Total labor force	1,168	1,307	1,781	...	...
Participation rate (in percent)	25.2	24.1	25.5	25.8	32.3
Income					
Percentage of private income received by					
Highest 20 % of households	...	42.0	...	...	...
Lowest 20 % of households	...	15.0	...	...	...
Other indicators					
Energy consumption per capita (kg of oil equivalent)	170.2	295.0	494.6	719.9	999.0
Percentage of dwellings with electricity	24.0	34.2	...	...	...
Passenger cars (per 1,000 inhabitants)	11.1	16.7	...	10.2	45.8

Source: Estimates provided by the IBRD.

1/ Mid-income reference country groups.

Note: Data availability is not uniform: 1965 refers to the closest year between 1962 and 1968; 1973 between 1970 and 1976; and 1985 between 1982 and 1985.