International Monetary Fund

Tunisia and the IMF

Press Release:
IMF Executive Board Completes Third Review Under the Stand-By Arrangement for Tunisia and Approves US$225 Million Disbursement
April 25, 2014

Tunisia: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

April 10, 2014

The following item is a Letter of Intent of the government of Tunisia, which describes the policies that Tunisia intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Tunisia, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

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Tunis, April 10, 2014

Madame Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, NW
Washington, D.C. 20431
USA

Madame Managing Director,

1. The Tunisian authorities reiterate their firm commitment to the economic program supported by the IMF. Recent political developments have given the Tunisian people renewed confidence and have opened the way for the holding of free and democratic elections. The adoption of the Constitution and the appointment of the members of the Independent Electoral Commission (ISIE) are expected to be followed by the adoption of the electoral law, which will establish a clear and precise timetable for legislative and presidential elections. We hope that this important step will help bolster both national and international confidence and will also lessen the wait-and-see attitude of investors. Nevertheless, the economic situation remains fragile, with the country growing at a rate that is too low to meet the population's very high aspirations. We remain convinced, however, that implementing prudent macroeconomic policies and structural reforms will allow us to maintain macroeconomic stability and promote sustained and more inclusive growth that will support Tunisia's development.

2. Performance under the IMF-supported program has been positive overall, especially, given the difficult national and international environment that Tunisia had to contend with as the new government was taking office. Moreover, performance at end-December 2013 was better than was expected at the time of the previous review, and we expect all performance criteria at end-March 2014 to have been met. However, owing to the political crisis and the ensuing wait-and-see attitude of investors that followed the appointment of the new administration, the pace of reform was slower than expected. We are committed to make up for the delay in the next weeks.

- *Performance criteria and quantitative targets.* As initially anticipated, the quantitative criteria for Net International Reserves (NIR) and Net Domestic Assets (NDA) at end-December 2013 were not met; however, the deviation from the target is considerably lower than previously estimated during the last review. The performance criterion on the primary balance of the central government (on a cash basis) at end-December was met as expected, although this performance is mainly due to the deferral to early 2014 of payments authorized in 2013. We have throughout adhered to the zero ceiling on the accumulation of external arrears and the non-accumulation of domestic arrears. The quantitative indicative target for social expenditures (which was missed in December 2013) and the ceiling on current expenditure at end-March 2014 are in line with projections.

- *Structural reforms*. Four of the eight structural benchmarks to be completed by March 2014 have been fully met (Table 2b). In particular, the electronic platform and the market makers agreement, which is now effective, have been implemented, a Treasury Single Account has been established, the impact study on the bank lending rate cap has been submitted to the CBT Board of Directors, and the preliminary audit report on state-owned enterprises' operations in the energy sector has been finalized. In turn, the benchmark concerning haircuts on all loans used as collateral has been partially met since the circular was issued but will only enter into force with effect from June 2014 after the lender of last resort facility is established. With regard to the benchmarks that have not been met: (i) the implementation decrees for the investment code will be finalized in September 2014 once the code has been approved by the National Constituent Assembly (NCA), which has a very full agenda; (ii) the targeted household support program, initially postponed to March 2014, is now scheduled for June 2014 and will be implemented ahead of the planned increase in fuel prices; (iii) a first draft of the tax administration modernization plan is ready, but the complete plan is only expected to be finalized in June 2014 following IMF technical assistance; and (iv) the strategic orientation for all banks with public participation (or at least for the STB and BH) will be approved by the Council of Ministers in mid-April 2014 (prior action). The strategy will then be presented to the public by end-April 2014.

3. As a result of the appropriate macroeconomic policies already implemented to achieve the key objectives of the program, and the ongoing implementation of the structural reform program (Tables 1 and 2a/2b), the government is requesting completion of the third review of the program supported by the stand-by arrangement as well as the disbursement of SDR 145.08 million. The government also requests a waiver of applicability for the quantitative performance criteria on NIR, NDA, and the primary balance at end-March 2014, which appear to have been met, but for which final data are not yet available. Further, the government would like to modify the performance criteria for NIR, NDA, and the primary balance at end-June 2014, and propose new criteria for September 2014, as well as new indicative targets, as described in the MEFP (Table 1) and the attached Technical Memorandum of Understanding.

4. This Letter of Intent is based on the previous Letter of Intent and Memorandum of Economic and Financial Policies (MEFP) approved on January 29, 2014. The attached MEFP outlines the key components of the government's program and the policies planned by the Central Bank of Tunisia, which we intend to implement during 2014. We remain determined to carry out our program with firm resolve, though mindful of the difficulties in the domestic, regional, and international environment.

5. We are confident that the policies described in the attached MEFP are appropriate to achieve the objectives of our economic program, which is designed to achieve short-term macroeconomic stabilization while laying the foundation for supporting growth and protecting vulnerable groups. We will remain vigilant and stand ready to take any additional measures that may be necessary to attain these objectives. We will consult with IMF staff on the adoption of

these measures, and in advance of any revision of the macroeconomic policies contained in this MEFP, in accordance with the IMF's policies on such consultations. All information and data necessary for program monitoring will be provided to IMF staff.

6. We authorize the IMF to publish this Letter of Intent and its attachments (MEFP, Tables 1, 2a 2b, and 3) as well as the related staff report.

Sincerely yours,

/s/	/s/
Chedly Ayari	Hakim Ben Hammouda
Governor of the Central Bank of Tunisia	Minister of Economy and Finance

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. RECENT DEVELOPMENTS AND MACROECONOMIC OUTLOOK

1. **The recovery of the Tunisian economy remains tentative given the difficult national context and a challenging international environment.** According to the latest data, economic growth in 2013—driven mainly by public and private services—amounted to around 2.6 percent year-on-year, with a downturn in the last quarter of 2013 (-0.3 percent on a quarterly basis). For 2014, despite the brighter outlook as a result of the return of confidence following the adoption of the Constitution and the formation of the new government, growth is expected to remain close to 2.8 percent, reflecting a relatively weak performance in the first two months of 2014 and the persistence of investors' wait-and-see attitude pending the outcome of the last phase of the political transition. There are also significant short-term risks related, in particular, to the possibility of a protracted political transition period, heightened social tensions, and a worsening of the economic outlook for Europe. Inflation (year-on-year) declined to 5.5 percent in February 2014, thanks to a slower rise in food prices and despite the electricity tariff increases of January 2014. Over the year, inflation is expected to remain contained at 5.6 percent, thanks to the slowing of food price rises, actions taken to control and monitor distribution channels, and a prudent monetary policy.

2. **The current account deficit worsened during 2013.** It reached 8.4 percent of GDP in 2013 (up from the initial program projected level of 7.5 percent of GDP), driven by weak exports of phosphates and energy, tourism revenues, and increase dividend transfers. On the other hand, the level of gross reserves in 2013, which was revised downwards during the previous review because of lower-than-expected external financial support, reached 7.7 billion dollars (3.5 months of imports of goods and services) following an increase in nonresidents' deposits, a valuation effect arising from exchange rate fluctuations, and the revaluation of the Central Bank of Tunisia's (CBT)'s gold holdings at market price. The higher confidence level seen in the last two months, ushered in by the adoption of the Constitution, also led to an initial rise in stock market activity and a lowering of the country risk premium for Tunisia. It also contributed to an appreciation of the exchange rate against the US dollar and the Euro, which was supported by strict enforcement of the exchange regulations and the intervention policy of the CBT.

II. PERFORMANCE UNDER THE PROGRAM AND STRATEGY

3. **We are fully committed to the rigorous implementation of the program to maintain short-term macroeconomic stability and lay the foundation for more sustained and inclusive growth.** The objectives of our program remain unchanged and we focused during this review on the following areas:

- **Preserving macroeconomic stability.** Controlling current expenditures, mobilizing revenues, and implementing a prudent monetary policy, coupled with limited CBT interventions in the foreign exchange markets, are needed to maintain macroeconomic stability.

- **Laying the foundations for inclusive growth.** Developing a strategic vision on the government's role in banks and reducing banking sector fragilities, improving the structure of the budget—underpinned by a better execution of public investment and growth-supporting fiscal reforms—as well as an ambitious structural reform agenda are needed to support private sector development, which is the main driver of growth.

- **Protecting the most vulnerable parts of the population** by strengthening social safety nets and systematically assessing the social impact of reforms.

A. Short-term Objectives: Restore Fiscal and External Buffers

Fiscal policy

4. In 2013, we achieved a primary deficit, on a cash basis, of 2.7 percent of GDP, which enabled us to meet the objective we set with a comfortable margin. The objective was met by implementing an active cash management strategy aimed at preserving part of the government's deposits in response to delays in the disbursement of donor financing (including the IMF). Further, the settlement of payment orders issued in FY2013 (up to January 31, 2014) was deferred to 2014 (around 3.3 percent of GDP) for payment within 90 days (except for public investments that remain linked to the execution of projects). In addition, savings on the wage bill and on social spending along with significant under-execution of investment spending (by around 1.5 percent of GDP compared to the budgeted amounts)—caused by absorptive capacity constraints at the regional level and unavoidable procurement delays—also contributed to this performance. Unfortunately, these absorptive capacity constraints were also responsible for the underperformance of social spending at end-December 2013, but the level set for end-March 2014 is expected to have been met.

5. The 2014 budget law—adopted in December 2013—is aimed at starting fiscal consolidation while preserving priority investment and development spending. The underlying fiscal position—as measured by the structural budget deficit—excluding the effects associated with the economic cycle and one-off transactions, such as bank recapitalization requirements or the repayment of arrears—was projected at 5.2 percent of GDP in 2014. At the time of the previous review, a deterioration of 0.6 percent of GDP compared to 2013 was observed, taking into account planned measures, including savings on unallocated expenditure (0.5 percent of GDP) and wages (0.2 percent of GDP, to offset the revenue shortfall from the suspension of the tax on vehicles included in the government's budget for 2014). The composition of the budget improved and fiscal pressures were further reduced by key elements included in the government budget:

- **Energy subsidy reform.** Our energy subsidy reform strategy is built around a multi-pronged approach and includes short- and medium-term measures:

  - Starting from January 1, 2014, we reduced energy subsidies extended to cement companies (gray cement) by raising the electricity rate and the price of natural gas for cement plants by 35 percent and 47 percent, respectively. On June 1, 2014, we plan to introduce a second electricity and gas price adjustment aimed at eliminating all subsidies to producers of grey cement (a gain of 0.2 percent of GDP). The program for the gradual adjustment of electricity and gas rates for other industrial consumers—to be implemented over a period of three to six years—is also being finalized, with an initial 10 percent rate increase already having been introduced in January and a second 10 percent increase planned for June 2014. To protect the most disadvantaged segments of the population, a social tariff was introduced for customers that consume less than 100 kwh per month. We are also committed to raising fuel prices by 6 percent by July 1, 2014, which is expected to result in savings of 100 million dinars on energy subsidies. These measures will be implemented even in the face of declining oil prices on the international markets, a further appreciation of the exchange rate, or a renegotiation of commercial contracts on more favorable terms.

  - The new fuel price adjustment formula is now in force but so far international prices have not yet reached the trigger of ten dinars per barrel in a quarter. Although the formula already provides assurances that the budgeted envelope will not be affected by any significant increases in international oil prices, a price smoothing mechanism is being considered to make it more resilient to large international price fluctuations.

  - Price adjustment has been accompanied by the implementation of social programs, already included in the 2014 budget, and the creation of the Energy Transition Fund to support the development of renewable energy. Additional programs (see Section C)—as well as a new communication campaign to explain the subsidy reform—will be carried out prior to any new price increases.

- **Controlling the wage bill.** We are committed to containing the wage bill in 2014 as was envisaged in the context of the program. We are determined to continue to engage in discussions with our social partners to explain the need to control the wage bill under the present circumstances. New recruitment will be frozen—except in the security forces, and education, and health sectors—to reduce the size of the wage bill. With a view to improving the preparation of the 2015 budget, we are in the process of finalizing the report assessing all new hiring since 2011 and we have set up a civil service reform task force. In addition, with the technical assistance from the World Bank, an evaluation of the civil service hiring system and salary structure is to be conducted, the findings of which could form the basis for a comprehensive civil service reform. The evaluation of the civil service salary structure will be finalized in September 2014.

6. **To address our financing constraints and reduce pressures on the balance of payments, we intend to prepare a supplementary budget law and make adjustments aimed at reducing the structural deficit to 4.9 percent of GDP.** In that regard, we have identified measures aimed at generating an additional 300 million dinars through revenue measures and savings on expenditure (see table 3). We also remain committed to taking additional measures to correct any deviation from the budgetary target, including through limiting current expenditures (namely subsidies and goods and services) that have in the past been a source of budget overruns (it is, however, important to note that we are on track to meet the end- March benchmark on current primary expenditure). Capital and social (which excludes subsidies) spending will be protected, and will not be constrained by our fiscal consolidation strategy.

Monetary and exchange rate policies

7. **The growth in monetary aggregates remains contained and inflation is under control.** The money supply (M2) rose by 6.9 percent year-on-year in 2013; however, the criterion on net domestic assets at end-December 2013 was not met due to a rapid increase in net credit to the government. The refinancing of banks by the Central Bank reached a peak on January 15, 2014 (5.5 billion dinars)—due to the need to compensate the shortfall arising from seasonal withdrawals of oil company deposits—and has since dropped back to 4.2 billion dinars at end-February 2014 and we estimate that the NDA criterion for end-March 2014 will be met.

8. **Monetary policy will continue to focus on containing inflation.** The increase in the policy rate by 50 basis points to 4.5 percent in December 2013—coupled with the introduction of a symmetrical corridor of 25 basis points around the policy rate—made it possible to normalize the market rate and narrow the gap with the policy rate. Although the real interest rate remains negative, we do not consider it necessary to increase the policy rate immediately given a stable core inflation (at around 4.5 percent), a negative output gap, credit to the private sector contained at 8.1 percent (year-on-year at end-January 2014), and the recent appreciation of the exchange rate. However, we stand ready to increase the policy rate further to contain any additional inflationary pressures caused by an accommodating budgetary policy and/or a rapid depreciation in the dinar exchange rate.

9. **The monetary policy transmission channel and access to financing will be strengthened by modifying the excessive lending rate system.** In March 2013, we eliminated the ceiling on creditor interest rates for term deposits, which had been introduced in December 2011. With regard to bank lending rates, we have finalized the impact study—conducted with World Bank assistance—on the modification or elimination of the legislation on excessive bank lending rates and have presented it to the Board of Directors of the Central Bank (structural benchmark at end-March 2014). On the basis of the study and of these recommendations, the CBT Board has asked for wider consultations with relevant Ministerial departments, before revising this year the legislation on excessive bank lending rates so as to enable the banks to preserve their profit margins, apply a higher interest rate to higher-risk customers, and improve monetary policy transmission channels as well as access to credit for small and medium-sized enterprises.

10. We will continue to implement our gradual exit strategy from liquidity injections. To that end, we have launched a process aimed at gradually limiting commercial banks' dependence on central bank refinancing, by increasing the share of refinancing guaranteed by government securities (to 20 percent at end-December 2013), and by introducing a ten percent haircut on loans accepted as collateral. The entry into force of a haircut system of around 25 percent (structural benchmark at end-March 2014) justified by a differentiation based on past nonperforming loans was postponed to June 2014 (the related circular will nonetheless be adopted by the CBT Board of Directors in March 2014). This will allow banks time to prepare for tightened liquidity conditions and to benefit from the implementation of a lender of last resort facility at end-June 2014 (structural benchmark). The facility will be established to ensure that the structural needs of solvent but illiquid banks are met at penalty rates and on the basis of a precise restructuring plan to improve the banks' liquidity position. Once the facility is in place, the share of government securities used as collateral in CBT refinancing operations will be increased to 40 percent (structural benchmark at end-December 2014). A study on the possibility of valuing government securities at market prices and not at their nominal value will be conducted by September 2014.

11. The work on the reform of the central bank law will begin in May 2014. In line with the recommendations of the safeguards assessment of the Central Bank of Tunisia, the provisions of the central bank law will be revised in order to strengthen the independence of the CBT, to improve its governance procedures, in general, and the modalities for the conduct of external audits as well as its internal audit and control functions, in particular. The revised draft law—prepared with the support of IMF technical assistance—will be submitted to the CBT Board of Directors in June 2014 (structural benchmark). It will be adopted by the government in September 2014.

12. The liquidity pressures that marked the foreign exchange market throughout 2013 eased in the first few months of 2014. Stricter enforcement of the existing regulations for the holders of professional accounts in foreign currency, the receipt of expected budget support, the confidence generated by the breakthrough in the political situation, and CBT interventions in the foreign exchange market all contributed to increasing supply of foreign exchange in the market. The dinar, therefore, appreciated against the dollar by 5 percent over the last three months compared to the Euro (and 4 percent against the US dollar), reducing by half the depreciation recorded in 2013. Nevertheless, the CBT continues to limit its interventions to ensuring the smooth processing of external payments. Currently, interventions only account for 30 percent of trades in the foreign exchange market (compared to 50 percent two months ago).

13. The exchange rate policy will continue to respect market rules. We have pursued our strategy of limiting CBT interventions in the foreign exchange market to smoothing excessive exchange rate fluctuations (intra-day), while allowing market forces to determine the trend of the exchange rate, which remains slightly overvalued (by around 7 percent). We are fully committed to using our intervention policy to strengthen our foreign exchange reserves, including through purchase of foreign exchange in the market when conditions would allow.

This will also help reduce the structural liquidity deficit of banks. The additional supply of foreign currency in the market will give banks the possibility to engage in swaps without approval from the CBT. To facilitate a more flexible exchange rate system, we intend to introduce weekly foreign exchange auctions before the end of 2014 (structural benchmark at end-December). The prerequisites for such auctions—namely the implementation of the electronic platform allowing the interconnection with banks and the entry into force of the Market Makers Agreement—are now in place (structural benchmark at mid-March 2014). However, before introducing the auction mechanism, there is also a need to first establish an efficient information system that would allow the CBT to centralize the flow of projected foreign currency payments and have a clearer overview of cash flows.

14. Our development strategy will remain open and based on free trade. In line with the rules of the World Trade Organization, we will impose new restrictions or surcharges on imports only as a last resort, after exhausting market solutions that preserve appropriate incentives and only with very clear and pre-announced criteria for their elimination.

B. **Laying the Foundations for Inclusive Growth**

Financial sector policies

15. The implementation of our policy to align Tunisia's prudential rules with international norms has shown that our banking sector remains fragile. The entry into force of the new prudential rules for the haircut of loan collateral has led to an increase in the provisioning rate (excluding accrued interests for nonperforming loans) in the banking system from 46 percent to 60 percent to cover risks from nonperforming loans (NPLs). In the wake of this change, the average capital adequacy ratio for the sector fell from 12 percent to 9.2 percent, with six banks below the 9 percent required by the new regulation in force. Although asset quality stabilized slightly in 2013, the situation remains fragile and the ratio of NPLs is 15 percent of total loans (20 percent with the inclusion of claims transferred to bank-affiliated asset management companies). Our gradual progression towards compliance with international standards—including a higher provisioning rate and a more stringent loan classification system—could show that current capital levels remain inadequate to support the excess risk in the system. However, the tightening of risk division and concentration norms—which entered into force at the end of 2013—have allowed a reduction of certain risks and continued progress towards international standards.

16. Bank compliance with prudential norms is essential. In that regard, we have requested all banks that fall below minimum capital requirements to prepare as soon as possible a detailed plan to raise capital to the required level (9 percent), which is scheduled to be increased by the end of the year to Basel II level (10 percent). We are also planning to adopt the same approach with regard to banks that are not in compliance with the liquidity ratio. A study assessing the impact of a new ratio—which will include off-balance sheet transactions and adopt a more forward-looking approach—was submitted to the CBT Board of Directors in February 2014 (structural benchmark at end-December 2013). The new ratio will be announced to banks through a CBT circular in September 2014, with a clear timetable for gradual implementation. In the interim, monetary sanctions will be applied for noncompliance with the prevailing liquidity ratio. Over the course of the year, we are also planning to move ahead with the implementation of consolidated-based prudential norms and to carry out regular monitoring of banks and their subsidiaries. We also plan to conduct a diagnostic study of internal risk rating systems for different segments and to put in place an action plan to deal with banks that fail to comply with the regulation in force by end-December 2014.

17. Reducing the vulnerabilities of public banks is our priority. We have improved the governance of public banks by giving them greater autonomy from the state, including with respect to hiring of staff and the appointment of Board members. We have completed the audits of two public banks (STB and BH), the results of which confirmed findings from the Financial Sector Stability Assessment (FSSA) and highlighted insufficient levels of equity, capital and provisions, a high level of nonperforming loans, excessive operating costs, personnel that lack the required skills and competencies, and weaknesses in the governance structure and quality of service. The audit of the Banque Nationale Agricole (BNA) had to be postponed because of a technical problem but will be finalized by July 2014 (new structural benchmark). Our action plan for the short term revolves around:

- **Strategy.** In view of the delays experienced with the audit of the BNA, the decision on the strategic approach to be adopted with regard to the role of the government in the national banking sector will be determined, among other elements, by the outcome of the audits of the two other public banks (STB and BH); and more particularly by the restructuring options for public banks proposed by the auditors. Possible options include: a new business model, possible merger, or the opening to further private partnerships. The strategy on the role of the state in all banks with public participation (or at least for the STB and BH) will be adopted by the Council of Ministers in mid-April 2014 (Prior Action). The strategy will be presented to the public at end-April. Following this, a restructuring plan for the two public banks (STB and BH) will be adopted in July 2014 (new structural benchmark) and funds for their recapitalization could be provided in the form of non-negotiable bonds. Depending on the strategy adopted and on the level of participation by the banks' private shareholders, the amount currently budgeted for bank recapitalization (1.2 percent of GDP) will be revised upwards or downwards (the amounts estimated by the audits of the two banks currently stands at 1.5 percent of GDP; while the FSSA estimated the needs of the public banks at 2.6 percent of GDP).

- **Asset Management Company (AMC).** In view of the urgency of the situation in our tourism sector (54 percent of the loans in the sector are nonperforming, with doubtful debts having doubled since 2009), we plan to submit a draft law on an AMC to the NCA in June 2014. The law will provide for the: (i) adoption of clear and transparent governance rules combined with financial and operational autonomy; and (ii) implementation of explicit power to speed up resolution of the debt issue. The capitalization of the AMC will be carried out in conformity with the business plan established with the support of the World Bank. This undertaking will be closely coordinated with the bank recapitalization program, in particular for public banks. In parallel to this project, work has started to identify a solution to the NPLs in other sectors (e.g. manufacturing industry). Further, during the course of this year, a revision of the law on asset recovery companies (Law 98) will be undertaken to make it possible for such companies to contact customers directly.

18. **Progress on reforming banking supervision is continuing.** We are in the process of introducing a formal risk-based banking supervision system—a three-year plan will be established with IMF technical assistance—that would determine the frequency and scope of inspection missions. A first general inspection of a large bank (the first since 2006) and four credit inspections provided an opportunity for the staff of the General Directorate of Banking Supervision (DGSB) to improve the methodology for on-site inspections and also highlighted the need to improve the risk management, data, and loan classification system. For FY 2014, a risk based inspection plan has been adopted in March 2014. The plan has identified six credit institutions, including four banks, for inspection. To perform these tasks, we have recruited 12 new people in the DGSB, that is, a quarter of the envelope provided for 2012–2014, and plan to fill the remaining vacancies to acquire the needed additional resources as soon as possible.

19. **Improvements in banking data reporting will enhance financial stability assessment and monitoring.** The CBT has developed a benchmarking indicator for credit institutions (Uniform Bank Performance Reporting, UBPR)—used jointly by the DGSB and the DGSFPR—which will be available 60 days after the end of each quarter and is based on a very simplified risk rating system. This instrument will be complemented by the new accounting, financial, and institutional banking data system to be put in place in December 2014 (structural benchmark).

20. **Efforts are underway to put in place a crisis management and bank resolution mechanism that is consistent with international best practices.** Regarding the legal framework, a draft banking law has been prepared with technical assistance from the World Bank and the IMF to strengthen banking supervision and regulation in Tunisia and put in place a robust legal framework for the resolution of insolvent banks. The draft law will be presented to CBT management in June 2014. In addition, the modalities for developing the operational structure and appropriate legal framework for the setting up of a deposit guarantee fund are in the process of being drafted with technical assistance from the World Bank.

Fiscal reform

21. **Improving the composition of public expenditures is needed to achieve growth-supporting medium-term fiscal consolidation and rebuild fiscal space.** Our medium-term fiscal consolidation strategy will be coupled with fiscal reforms—tax policy, revenue administration, public financial management, public enterprise reform, effectiveness of public investment—which are all essential to support growth.

22. A number of fiscal policy measures, including the grouping of tax laws in a new tax code in 2014, will help to improve the equity, efficiency, and transparency of the tax system. On the basis of tax consultations that took place between June and November 2013, we have developed a report which forms the basis of a strategy for a simpler and fairer taxation system. This report will be discussed publicly at the national tax consultations planned for June 2014 and will be used as the basis for establishing a new tax code to be adopted by the Council of Ministers in September 2014 (structural benchmark). In the context of a comprehensive tax reform, we plan to continue revising the corporate income tax (CIT) to achieve gradual convergence in the off-shore and on-shore sectors over the next few years, and announce it according to a clear calendar (the difference between the tax rates in these two sectors was reduced by half in the context of the 2014 budget law). Further, a study is underway to modify the existing presumptive tax system, including for liberal professions.

23. The pace of tax administration reform will be stepped up through the implementation of a modernization plan. A diagnostic study on tax administration was conducted in February 2013, with the support of IMF technical assistance. Following the diagnostic, we set up an in-depth verifications unit and a claims monitoring committee within the Large Taxpayers Office (LTO). Along the lines of the regional centers, a debt collection center has been set up. In addition, we plan to pursue our efforts to strengthen and restructure the Large Taxpayer Unit (LTU), by including all tax functions, and to strengthen tax control by improving selectivity (establishment of targeted criteria and objectives). We have also decided to strengthen control of the presumptive tax rate system (BNC), using the data available in the health insurance and social security system and the available banking data. A plan to modernize tax administration will be finalized in June 2014 (end-March SB postponed to June 2014). It will aim at setting up a unified administration and strengthening control and evaluation mechanisms, in line with the IMF technical assistance recommendations and with the assistance of an IMF resident expert. A unit responsible for overseeing the modernization of the tax administration will be created in April 2014 within the General Directorate of Taxation to monitor the implementation of the plan (organization, instruments, and working methods). With regard to customs administration, we have set up the first risk management unit, which has made it possible to introduce targeted inspections in the customs offices. We remain determined in our fight against smuggling, which has spiraled since the revolution, and intend to further strengthen our border posts.

24. The performance of public enterprises places a heavy burden on the government's budget. Since March 2014, we have taken concrete measures to control the increasing losses of public enterprises, primarily in transportation (Tunisair), trade (Grain Board), and energy (STEG, STIR), by shortening the required timeframes for transferring the amounts due to the enterprises eligible for subsidies on energy and food products. To strengthen governance and ensure greater transparency in the system of energy subsidies, cross subsidization between the energy companies will be reduced by having STEG and STIR meet directly their energy import needs from June 2014, instead of going through ETAP (oil refinery). Furthermore, the General Financial Committee (*Comité Général des Finances*-CGF) has prepared a preliminary audit report on the operations of the three public enterprises in the energy sector (structural benchmark at end-March 2014). To save them expensive bank interest expenses, the Ministry of Finance is committed to providing enterprises that receive energy and food subsidies with advances on budget appropriations to reduce their recourse to bank loans (the share of public enterprises in total loans was around 10 percent in 2013, distributed almost evenly between public and private banks). To better assess the challenges facing the sector, we plan to:

- **Strengthen the monitoring of public enterprises.** A monitoring committee bringing together the DG for Holdings, the CBT's DGSFPR, and the Unit responsible for Monitoring the Productivity of Public Enterprises and Institutions (Office of the Head of Government) is looking into the financial, and organizational situation of a group of 28 enterprises considered to be the most important in terms of their impact on the national budget and economy. This monitoring exercise will be further strengthened by the preparation of a consolidated balance sheet for the 20 largest public enterprises (structural benchmark at end-June 2014), to make it possible to have a more precise estimation of the real impact on the government budget. A preliminary report including financial ratios will be finalized in April 2014. A quarterly report on the financial situation and action plans for rehabilitating loss-making enterprises will be published for the first time in June 2014.

- **Improve the governance of public enterprises.** In parallel with the assessment of their financial situation, the strategy aimed at strengthening public enterprises will also include efforts to review the regulatory framework to enhance the role of their board of directors, set up audit committees, and increase the transparency of their operations.

25. Public Financial management has been strengthened. In the interest of transparency, the government published a "citizens' budget" for the first time in its history and has strictly respected the budget execution procedures during the complementary period by respecting the time frame provided for under the law. Further, a first draft organic law that is expected to introduce greater flexibility in the management of appropriations (including in ex-ante controls) and greater accountability of managers was prepared by the Budget Directorate. The law was drafted with technical assistance from the European Union and France and will be presented to the Council of Ministers in September 2014. It is designed to introduce, over the medium term, an ambitious program of "performance budgeting" (at present nine ministries—around 70 percent of the budget—present their budget with performance objectives). To improve the management of the government's cash position and reconcile the monetary and fiscal data on government financing, we have consolidated the government's accounts, excluding project loan accounts, in a Treasury Single Account (structural benchmark at end-March 2014). We also intend to assess the exhaustiveness and quality of the budget documentation and prepare a report on financial risks. Immediate efforts will focus on the preparation of a new budgetary nomenclature consistent with international standards. The draft of the new functional classification of the budget will be finalized in June 2014.

26. Improving the execution and effectiveness of investment spending is needed to generate inclusive growth. In collaboration with the World Bank, a diagnostic study on public investments has highlighted the need to implement major critical projects that could have a real impact on disadvantaged regions. Moreover, we have simplified, improved, and considerably modernized our procurement procedures, consistent with the recommendations of the World Bank technical assistance program, which will be implemented in June 2014 (the decree was approved in March 2014). This will allow for a more rapid and transparent relaunch of investments. We have also strengthened the control of public investments so as to ensure that the current practice of transferring loans to the regions to finance investment expenditures, which are under-executed and consequently rolled over to subsequent fiscal years, is no longer the norm. For the regions, we have decentralized project execution by professionalizing the oversight of public projects, reinforcing the role of Governors and carrying out periodic visits by the central government. Furthermore, we have also adopted procedures to address land deeds issues that lead to delays during the project preparation phase and in the execution of investment spending.

Structural reforms

27. Our structural reform agenda focuses on improving the business environment and promoting a competitive private sector that will generate inclusive growth. To this end, we have been working mainly on the implementation of a new investment code, a new competition law, the streamlining of regulations and procedures as well as on facilitating trade.

28. The implementation of certain reforms requires the enactment of new laws, and is, thus, dependent on the political calendar of the National Constituent Assembly, given the priorities related to the electoral law. Nonetheless, we are committed to moving forward with the legislative timetable to pass the following laws:

- **The investment code**—has been prepared with technical assistance from the World Bank and on the basis of consultations with civil society and the donor community. The code—which aims to encourage private investment through a more transparent and effective regulatory framework and the streamlining of incentives—was submitted for approval of the National Constituent Assembly(NCA) in November 2013, but will only be examined in June 2014, thus delaying the implementation of the implementation decrees (structural benchmark at end-March 2014). These decrees—which are needed to increase market access and reduce restrictions on investment—can only be finalized after June 2014 (new structural benchmark for end-September 2014).

- **The competition law.** The draft law—submitted to the NCA in 2013—will be examined by the NCA by June 2014. The final version of the competition law will be designed to reduce government intervention in the economy, reduce excessive regulations, and strengthen competition among enterprises.

- **The law on collective proceedings (Law 95).** In parallel with the reform of the banking law, we will step up our efforts to ensure that the new law on collective proceedings (bankruptcy procedures)—prepared with the World Bank assistance—is adopted. The law is aimed at modernizing and simplifying the process of restructuring firms and liquidating insolvent firms. We will ensure that the new legislation on bankruptcies establishes clear rules on the government's status as a preferred creditor as well as on granting private creditors the right to vote on recovery plans.

29. **Closer integration of the Tunisian economy into the global economy is essential for generating more inclusive growth.** We are committed to promoting trade, including by reducing tariff and non-tariff barriers and through the recently implemented free trade agreement with Algeria as well as by the deepening of trade agreements with neighboring and African countries. Negotiations for a Deep and Comprehensive Free Trade Area (ALECA) with the EU will be launched in 2014. To further enhance the integration of the Tunisian economy into the global economy, we have developed an action plan to improve the logistics systems of the Rades port (Tunisia's main port) and build a new deep water port at Enfidha.

30. **Work is ongoing on the simplification of administrative procedures,** including in the area of tax collection and customs, to promote private sector development and limit space for the discretionary application of regulations. To this end, we have begun to phase out restrictive administrative procedures for the private sector in the transport, customs, and export sectors; and we are committed to continuing along these lines as we believe that significant benefits will arise for the business community from this regulatory clean-up campaign, including for procedures related to the VAT.

31. **We are committed to reducing the obstacles to a proper functioning of the labor market.** The practical implementation of the social contract signed on January 14, 2013 with the employers and trade unions has begun with the setting up of technical commissions (labor and professional relations, social protection, employment, regional development, and investment). Broad consultation is planned for discussion of the new employment strategy. This process is expected to culminate in labor reform, including an analysis of flexicurity in labor relations and a reduction of the structural skills mismatch. With respect to employment, promotion programs and micro project programs financed by loans from the solidarity bank and the employment fund will contribute to foster youth employment.

32. **Reliable statistical information is crucial for the monitoring and assessment of macroeconomic policies and for the implementation of social programs.** In that context, we are collaborating with Eurostat in conducting a comprehensive diagnostic study of our statistics system, and we also plan—with technical assistance from the IMF—to strengthen our institutional arrangements and production of the system of national accounts (particularly on the quarterly demand side), and the balance of payments. We will continue to expand on the regular publication of the results of surveys on current conditions, employment, and household living conditions. In parallel, work on the legislative framework guaranteeing the independence on the National Statistical Office has been initiated.

C. Protecting the Most Vulnerable

33. We are firmly committed to ensuring that fiscal consolidation and other reform projects fully take into account the impact these reforms might have on the most vulnerable and that they be accompanied by a simultaneous strengthening of the social protection system. In that context, the government's 2014 budget includes the following social measures:
(i) a social housing program for needy families; (ii) an increase in the income tax deduction for the poorest households; and (iii) a tiered electricity rate system adapted to energy use, and which introduces a second social ("lifeline") electricity tariff (for households that consume less than 100 kwh per month). Over the course of 2014, we plan to enhance our information system by introducing a unique social identification number that will be used as a basis for creating a new register of families in need and ensuring a more efficient targeting of benefits (under the current system there is quite a significant amount of "leakages" of benefits going to the non-poor). While waiting for the implementation of the new register, we have launched an evaluation of the school assistance programs (with the help of UNICEF) as well as an assessment of the families-in-need/health benefits card program, both of which should be finalized by June 2014. In view of the planned increase in fuel prices, we intend to set up a "household targeting strategy" that is expected to take effect on July 1, 2014 and will consist of the following measures: (i) expansion to 250,000 beneficiary families (from 220,000 at present) of the existing cash transfer program for needy families; (ii) broadening of the population groups eligible for one-off and temporary aid to mitigate the impact of the fuel price increases; targeting will use the databases of the STEG and social security or any new social identification numbers; and (iii) a 10-dinar (about 10 percent increase) in the social allowances for school children and university students at the start of the academic year.

34. The reform of the pension system remains a medium-term priority. The retirement and health insurance systems are considered financially unsustainable over the long term. If these systems are not reformed, the combined deficit could amount to 2 percent of GDP by 2018. To address this risk, the Tunisian government has begun analyzing scenarios for retirement and health insurance reform, in parallel with the implementation of a support and welfare program financed by the transition fund to ensure the viability of the system. A decision on the reform to be adopted will be taken on the basis of a national consensus reached through the consultative process that was already started with the launch of the social pact in January 2013.

Table 1. Tunisia: Quantitiative Performance Criteria and Indicative Targets 1/2/

	Dec 2012	Cumulative flows since the beginning of 2013					Cumulative flows since the beginning of 2014						
		Dec 2013					Mar 2014			Jun 2014		Sep 2014	Dec 2014
		Prog. 05/24/13	PC w/ adjusters	Prog. 01/24/14	Actual	PC Status	Prog. 01/24/14	PC w/ adjusters	Revised estimate	Prog. 01/24/14	Revised PC	PC	IT
Quantitative Performance criteria							(Millions of Tunisian Dinars)						
1. Floor on the primary balance of the central government (cash basis excl. grants)	-2,256	-4,318	-3,818	-2,015	-2,032	Met	-2,796		-1,773	-3,119	-2,806	-4,007	-5,609
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock)	-1,332	-1,084	417	3,510	1,382	Not Met	3,952	4,340	3,009	4,662	4,086	4,071	1,173
							(Millions of US$)						
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock)	7,937	8,066	7,099	5,439	5,710	Not Met	5,308	5,058	5,071	5,086	4,754	5,275	7,066
Continuous Performance criteria							(Millions of Tunisian Dinars)						
4. Ceiling on the accumulation of new external debt payment arrears by the central government	...	0		0	0		0		0	0	0	0	0
Quantitative Indicative Targets							(Millions of Tunisian Dinars)						
5. Ceiling on Current Primary Expenditure							4,253	4,253	4,010	8,432	8,267	12,796	17,815
6. Floor on Social Spending 3/	1505	1,588		1,371	1,281	Not Met			229	...	562	900	1,350
7. Ceiling on the accumulation of new domestic arrears	...	0		0	0	Met	0		0	0	0	0	0
Program assumptions on which adjusters are calculated in case of deviations													
Disbursment of public external Financing on a cumulative basis (in US$ million) 4/		2,239		845	859		544		296	984	707	1,163	2,771
Public debt service (interest and amortization) on a cumulative basis (in US$ million)		1,387		1,379	1,344		208.2		213	503	516	718	968
Bank recapitalization (in million TD)		500		500	500		...		0	0	0	300	700
Privatization receipts (in million USD)	394	41		39	39		...		0	0	0	0	0
Resident deposits at the BCT (in million USD) 5/	1,490			1,852	1,854		...		1,854		1,854	1,854	1,854
Program exchange rate TD/ U.S. dollars	1.55235			1.55235	1.55235		1.55235				1.55235	1.55235	1.55235

1/ Quantitative performance criteria and structural benchmarks are described in the Technical Memorandum of Understanding.
2/ For purposes of calculating program adjusters, foreign currency amounts will be converted at program exchange rates.
3/ Public capital expenditures on social sectors and programs.
4/ Excludes IMF disbursments.
5/ At program exchange rate.

Table 2a. Tunisia: Structural Benchmarks for 2013

	Objective	*Date*	Comments
Structural Benchmarks			
I. Financial sector			
Approval of the new reporting system architecture covering bank-related accounting, financial and institutional functions.	*Financial sector stability*	*Aug-13*	MET, with delay. The reporting system was presented in September 2013. This report defines the main principles of the architecture and its conception as well as different phases of the risk model.
Adoption by the Council of Ministers of the strategic vision of the government's future role in banks on the basis of preliminary results from the audit of public banks.	*Financial sector stability*	*mid-September 2013*	NOT MET. Audit of the three banks started in July and September, which is delaying the decision on the strategic vision. The strategic vision has been pushed to March 2014.
General on-site inspection of one major bank and inspection of the credit risks of four other banks.	*Financial sector stability*	*Dec-13*	MET. A credit risk inspection at one bank was completed in September and three others were completed in December. The on-site inspection of one major bank was completed in December 2013.
Presentation to the Board of the CBT of a study concerning the impact on banks of liquidity ratio changes toward international standards.	*Financial sector stability*	*Dec-13*	MET, with delay. The templates for collecting the date needed to conduct the impact study have been communicated to banks. The study has been presented to the CBT Board in February 24.
II. Fiscal policy			
Aproval by the Council of Ministers of the corporate tax reform announcing the convergence of the tax rates of onshore and offshore sectors for 2014 and identification of countervailing measures to ensure a neutral impact on revenues.	*Minimization of distortions, and tax fairness and simplification*	*Jul-13*	MET, with delay. The reduction of the on-shore corporate tax rate from 30 to 25 percent and the increase of the off-shore one from 0 to 10 percent was incorporated in the 2014 draft budget along with countervailing measures for the potential revenue loss. The draft budget has been approved by the Council of Ministers on November 18, 2013 and has been adopted by Parliament on December 30, 2013.
Adoption of a Ministry of Industry decree approving a new automatic fuel pricing formula.	*Lower energy subsidies*	*Aug-13*	MET, with delay. An automatic pricing mechanism was put in pace allowing convergence to international prices, but does not allow smoothing for large price increases.
Submission to the Council of Ministers of a new targeted household support program to accompany the reform of generalized energy subsidies	*Protection of society's most vulnerable segments*	*Aug-13*	Not MET. The technical work has been done. A decision on the beneficiaries and the compensating mechanism need to be taken.
Merge at the level of the large taxpayer unit the management, tax collection, and control of large enterprises.	*Broadening of the tax base*	*Sep-13*	MET, with delay. The different functions have been put together in one unit.
Finalize the audit of the electricity company (STEG) and of the petroleum refinery company (STIR).	*Lower fiscal risks*	*Dec-13*	Not Met. The audit of the three energy companies (STEG, STIR, ETAP) have started. This benchmark has now been postponed to March 2014.
III. Monetary and exchange rate policy			
Publication of a circulaire by the CBT that announces haircuts on all loans used as collateral for refinancing operations at the Central Bank.	*Enhancement of the monetary transmission mechanism*	*Jul-13*	MET. The circulaire, which was adopted at end-July, includes a general haircut of 10 percent.
Ensure that the proportion of the refinancing volume at the CBT backed by government securities is at least 10 percent for each bank.	*Enhancement of the monetary transmission mechanism*	*Aug-13*	MET. The circulaire has been published and the SB has started.
Implementation of an electronic bank interlinking platform and launch of the Market Makers Agreement.	*Greater exchange rate flexibility*	*Oct-13*	NOT MET, because of technical delays. This is a new structural benchmark for mid-march 2014.
Ensure that the proportion of the refinancing volume at the CBT that is backed by government securities is at least 20 percent for each bank.	*Enhancement of the monetary transmission mechanism*	*Dec-13*	MET. The CBT regulation has been published and implemented.
IV. Structural reforms/private-sector development			
Adoption of the Investment Code (tax measures will be referred to in the tax code).	*Support for balanced growth driven by the private sector*	*Jul-13*	MET, with delay. The new code was approved by the Council of Ministers in November 2013. Next step in this area will be the drafting of the implementation decrees that should accompany ratification by Parliament.

Table 2b. Tunisia: 2014 Structural Benchmarks

	Objective	Date	New Date	Comments
Prior Action				
Adoption by the Council of Ministers of the strategic vision of the government's future role in banks (or at least in STB and BH) on the basis of preliminary results from the audit of public banks	*Financial sector stability*			
I. Financial sector				
Submission to the Management of the Central Bank of Tunisia of a banking resolution framework in line with international practices	*Crisis management and financial sector stability*	*Jun-14*		In progress. With help from WB and IMF technical assistance.
Submission to the Central Bank Board of a draft Central Banking law in line with international practices	*Financial sector stability*	*Jun-14*		In progress. An IMF technical assistance mission is planned for May 2014.
Completion of the financial audit of the Banque Nationale Agricole (BNA)	*Financial sector stability*	*Jul-14*		
Adoption by the Government of retructuring plans for the BH and STB	*Financial sector stability*	*Aug-14*		
Development and implementation of the new reporting system and bank classification system	*Financial sector stability*	*Dec-14*		
II. Fiscal policy				
Adoption by the Ministry of Finance of a plan to modernize tax administration	Enhance Revenue Collection	Mar-14	Jun-14	**Not MET**. Working groups have worked on a draft plan but an overall strategy still needs to be finalized. IMF TA is assisting the authorities.
Unification of government accounts into a Single Treasury Account (excluding accounts for project loans)	Public Financial Management	Mar-14		MET.
Finalize the audit of the electricity company (STEG) and of the petroleum refinery company (STIR)	Lower fiscal risks	Mar-14		MET. The First Report was submitted to the Government on March 30, 2014.
Submission to the Council of Ministers of a new targeted household support program to accompany the reform of generalized energy subsidies	*Protection of society's most vulnerable segments*	Mar-14	Jun-14	**Not MET**. Work is in progress and possible contents of the strategy have been identified. This program will be put in place prior to the planned increase in fuel prices.
Prepare a consolidated balance of 20 main public enterprises (2010-2012)	*Improvement of budgetary control and reduce fiscal risks*	*Jun-14*		
Government approval of a new tax code	Enhance Revenue Collection	*Sep-14*		
III. Monetary and exchange rate policy				
Implementation of an electronic bank interlinking platform and launch of the Market Makers Agreement.	*Greater exchange rate flexibility*	*mid-Mar 2014*		MET. The electronic platform allowing the interconnection with banks and the Market Makers Agreement are now in place.
Presentation to the Central Bank board of the impact study for removing the upper limit for excessive rates for enterprises and to modify it for consumers.	*Financial system stability and better transmission of monetary mechanisms*	*Mar-14*		MET. The impact study—done with help from the CBT and completed with WB assistance—was presented to the CBT Board on March 26, 2014.
Implement an increase of the haircut for loans used as collateral for refinancing operations to at least 25 percent.	*Enhancement of the monetary transmission mechanism*	*Mar-14*	*Jun-14*	**Not MET**. A new regulation has been adopted on March 25, 2014 and its application will be announced for June 2014.
Establishment of the lender of last resort facility	*Financial system stability and better crisis management*	*Jun-14*		In progress. IMF TA is providing assistance.
Ensure that the proportion of the refinancing volume at the CBT backed by government securities is at least 40 percent for each bank.	*Enhancement of the monetary transmission mechanism*	*Dec-14*		
Implementation of a weekly foreign exchange auction mechanism	*Greater exchange rate flexibility*	*Dec-14*		
IV. Structural reforms/private sector development				
Decree for implementing the new investment code in line with the objective of protecting market access, reducing restrictions on investments, and rationalizing of incentives.	*Support for balanced growth driven by the private sector*	*Mar-14*	*Sep-14*	**Not Met.** Implementation decrees will be finalized once the investment code is ratified by Parliament.

Table 3. Tunisia: Fiscal Compensatory Measures – March 2014

	In Million Dn	In Percent GDP
Fiscal Revenues	260	0.3
Tax Policy Measures	100	0.1
Alcoholic Beverages: 8 percent Increase Excise Tax	20	0.0
Tabac: 10 percent Increase Excise Tax	50	0.1
No tax exemption for imported vehicles 1/	30	0.0
Tax Administration Measures	160	0.2
Tunisie Telecom: enhanced tax control	110	0.1
Recovery of tax arrears awaiting judicial decision	50	0.1
Current Expenditures	40	0.0
Additional reduction of energy subsidies 2/	40	0.0
Total	300	0.4

1/ At the moment of resale for cars imported by tunisians leaving abroad.

2/ Bringing forward the planned increase of tariffs to May 2014.

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This Memorandum establishes the agreement between the Tunisian authorities and IMF staff concerning the definition of the quantitative performance criteria and indicative targets. It also sets out the content and frequency of data reporting to IMF staff for program monitoring purposes.

2. The quantitative criteria and targets are defined in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated April 10, 2014. For program purposes, all assets, liabilities, and flows denominated in foreign currencies will be valued at the "program exchange rate," as defined below, with the exception of items affecting the government's budgetary accounts, which will be measured at current exchange rates. For program purposes, the exchange rate corresponds to the accounting exchange rate of the CBT prevailing on December 31, 2012, as shown in the table below. For the SDR, the program exchange rate is 1SDR = 2.38852 Tunisian dinars.

Program Exchange Rates, Tunisian Dinar per FX Currency,
(Accounting Exchange Rate of the CBT)
December 31, 2012

Currency	Units	Exchange rate
Algerian dinar	10	0.19860
Saudi riyal	10	4.13930
Canadian dollar	1	1.56175
Danish krone	100	27.44020
USA dollar	1	1.55235
British pound sterling	1	2.50510
Japanese yen	1000	18.02650
Moroccan dirham	10	1.83535
Norwegian krone	100	27.73730
Swedish krona	10	2.37995
Swiss franc	10	16.95450
Kuwaiti dinar	1	5.51955
United Arab Emirates dirham	10	4.22660
Euro	1	2.04725
Libyan dinar	1	1.23740
Mauritanian ouguiya	100	0.51230
Bahraini dinar	1	4.11770
Qatari riyal	10	4.26380

Source: Central Bank of Tunisia.

3. Monetary gold assets will be valued at the price of 0.6498 dinar per gram of gold as established in the decree No. 86-785 of August 18, 1986. The stock of gold is 6.73 tons (6739902 grams) on December 31, 2012.

4. For data reporting purposes, the Ministry of Economy and Finance, the National Institute of Statistics (INS), and the Central Bank of Tunisia (CBT) will follow the rules and

the format considered appropriate for data reporting as covered by this technical memorandum of understanding, unless otherwise agreed with IMF staff.

DEFINITION OF PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Performance Criteria and Indicative Targets

5. **The quantitative performance criteria and indicative targets specified in Table 1 of the MEFP are**:

Performance criteria

- A performance criterion (floor) on the net international reserves of the Central Bank of Tunisia.
- A performance criterion on the net domestic assets (ceiling) of the Central Bank of Tunisia.
- A performance criterion (floor) on the primary balance of the central government, excluding grants.
- A continuous performance criterion on the accumulation of external arrears (zero ceiling).

Indicative targets

- An indicative target (ceiling) on total domestic arrears.
- An indicative target (ceiling) on total primary current expenditure of the central government.
- An indicative target (floor) on capital expenditures in priority social sectors and social programs.

6. **Measurement of criteria.** The performance criteria on net international reserves and net domestic assets are measured on a stock and quarterly basis. The performance criterion on the central government deficit is measured on a quarterly basis and cumulatively from the end of the previous year. Adjustment factors will also be applied to some of these criteria. The performance criterion on the accumulation of external arrears is measured on a continuous basis.

B. Institutional Definition

7. The **central government** comprises all ministries and agencies subject to central budgetary administration in accordance with the organic law on the government budget. Regional governments and municipalities subject to central budgetary administration are part of the central government.

8. The authorities will inform Fund staff of any new entity and any new program or special budgetary or extra-budgetary fund created during the period of the program to carry out operations of a budgetary nature. Such funds or new programs will be included in the definition of the central government.

C. Floor on the Net International Reserves of the Central Bank of Tunisia

9. The **net international reserves (NIR)** of the Central Bank of Tunisia (CBT) are defined as the difference between the CBT's reserve assets and its liabilities in foreign currency to nonresidents.[1]

10. The **CBT's reserve assets** are the foreign assets immediately available and under the CBT control, as defined in the fifth edition of the IMF *Balance of Payments Manual*. They include gold, SDR assets, reserve position at the IMF, convertible foreign currencies, liquid balances held outside Tunisia, and negotiable foreign securities and bills purchased and discounted.

11. The **CBT's liabilities in foreign currency** to nonresidents include any commitment to sell foreign currencies associated with financial derivative transactions (such as swaps, futures, options), any portion of the CBT's assets (gold, for example) used as collateral, IMF and Arab Monetary Fund (AMF) credits outstanding, and deposits at the CBT of international organizations, foreign governments, and foreign bank and nonbank institutions. The government's foreign currency deposits at the CBT are not included in the liabilities, nor is any SDR allocation received after May 15, 2013.

12. All debt instruments issued in foreign currency by the CBT on behalf of the government before May 15, 2013 are also excluded as liabilities of the CBT. All debt instruments issued in foreign currency by the CBT on behalf of the government after May 15, 2013 will be treated as **CBT liabilities**, unless the offering documents (prospectus) state clearly that (i) the CBT is acting as an agent to execute all sovereign debt instruments issued in foreign currency raised through the international markets for general budgetary purposes of the Republic of Tunisia (ii) debt is a liability of the central government; and (iii) a protocol between the CBT and the Ministry of Finance provides clearly that the CBT is authorized to

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[1] Deposits of residents in foreign currency (excluding government deposits) at the CBT are a form of external liability of the CBT; for operational and accounting purposes, and because of legal considerations related to the regulation of foreign exchange, the CBT includes residents' foreign currency deposits in the monetary base. To preserve the accounting consistency of the CBT's accounts and be in line with the standard definition of NIR within the framework of IMF stand-by arrangements, it is agreed: (i) to retain the accounting definition of external liabilities used in the CBT balance at December 31, 2012; (ii) to adopt the principle of adjusting NIR (in the opposite direction of the net domestic assets of the CBT) on the basis of the variation in the residents' deposits in foreign currency from end-December of the previous year. It also agreed that the residents' deposits in foreign currency at the CBT include the following components of reserve money: intervention/monetary market in foreign currency, foreign currency of aggregate intermediaries, non-negotiable placement of foreign currencies, and all other items of deposits in foreign currencies created or included in reserve money. At end-December 2013, the value of the stock of deposits in foreign currencies of residents at the CBT was US$1,852.07 million at the program exchange rate.

pay all expenses and costs pertaining to the implementation of this issue as well as the interest and principal of the issue sum through direct deduction from the Treasury's current account established in the CBT's books.

13. The value of CBT reserve assets and liabilities in foreign currency will be calculated using program exchange rates (see Table above). On December 31, 2012, the value of the stock of net international reserves was US$7.937 billion, with the stock of reserve assets equal to US$8.645 billion and the stock of CBT liabilities in foreign currency equal to US$730.399 million (at program rates).

D. Ceiling on Net Domestic Assets

14. The **CBT's net domestic assets** are defined as the difference between the monetary base and the net foreign assets of the CBT.

15. The **monetary base** includes: (i) fiduciary money (money in circulation outside the banks and cash balances of commercial banks); (ii) deposits of commercial banks at the central bank (including foreign currency and deposit facility); and (iii) deposits of all other sectors at the central bank (i.e., other financial enterprises, households, and companies).

16. The **CBT's net foreign assets** are defined as the difference between the CBT's gross foreign assets, including foreign assets that are not part of the reserve assets, and all foreign liabilities of the CBT. Net foreign assets are valued at the program exchange rate defined in the above table.

E. Floor on the Primary Balance of the Central Government (Excluding Grants)

17. Under the program, the **primary fiscal balance of the central government (excluding grants, on a cash basis)** is measured on a financing basis and will be the negative sum of: (i) total net external financing; (ii) privatization receipts; (iii) net domestic bank financing; (iv) net domestic nonbank financing; *plus* (v) interest on domestic and external debt paid by the central government and *less* external budgetary grants received by the central government.

18. **Total net external financing** is defined as net external loans of the government, that is: new loan disbursements, *less* repayments of the principal. Project and budgetary loans of the central government are included, as well as any form of debt used to finance central government operations.

19. **Privatization receipts** are the government receipts from the sale of any government asset. This includes revenues from the sale of government shares in public and private enterprises, sales of nonfinancial assets, sales of licenses, and the sale of confiscated assets, excluding the confiscation of bank accounts. For the adjustor in NIR (see below), only receipts in foreign currency are included.

20. **Net domestic bank financing of the central government** is the sum of: the change in net bank loans to the central government (in Tunisian dinars and foreign currency) and the change in central government deposits at the CBT (this includes all central government accounts at the CBT, in particular (i) Treasury current account; (ii) Tunisian government account (miscellaneous dinar accounts); (iii) loan accounts; (iv) grant accounts; (v) FONAPRA-FOPRODI accounts; (vi) special account of Tunisian government in foreign currency; (vii) current accounts of paying U.S. Treasury; (viii) accounts in foreign currency pending adjustment (subaccount: available); (ix) and any other account that may be opened by the central government at the CBT. Following the unification of government accounts at the CBT into a Single Treasury Account, government accounts are consolidated in two categories ("Compte Central du Government "and "Comptes Spéciaux du Government") on the CBT's balance sheet (liabilities side).

21. **Net government borrowing from the banking system** is defined as the change in the stock of government securities (Treasury bills and bonds) held by banks and any other central government borrowing from banks, less repayments. The stock of nonnegotiable bonds issued to banks during the recapitalization of public banks, and which are serviced entirely by the government, is excluded from bank claims on the government.

22. **Net domestic nonbank financing** includes: the change in the stock of government securities (Treasury bills and bonds) held by nonbanks (including social security funds) and any other central government borrowing from nonbanks, less repayments. Total Treasury bills and other public debt instruments to be taken into consideration are calculated at the nominal/face value shown on the institutions' balance sheet and does not include accrued interest.

F. Ceiling on the Accumulation of External Arrears

23. **Arrears on external debt payment** are defined as late payments (principal and interest) on external debt or guarantees as defined in *External Debt Statistics: Guide for compilers*[2] by the central government or the CBT after 90 days from the due date or the expiration of the applicable grace period.

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[2] The definition of debt set forth in *External Debt Statistics: Guide for Compilers* reads as the outstanding amount of those actual current, and not contingent, liabilities, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to nonresidents by residents of an economy. Debts owed to nonresidents can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property.

G. Indicative Ceiling on the Accumulation of Domestic Arrears

24. For program purposes, arrears on **domestic debt payment** are defined as amounts owed to domestic financial and commercial creditors that are 90 days or more overdue with respect to a specific maturity date (or as defined in the contractual grace period, if any). If no maturity date is specified, arrears are defined as amounts owed to domestic creditors that remain unpaid 90 days or more after the date on which the contract was signed or upon receipt of the invoice.

H. Indicative Ceiling on Central Government Primary Current Expenditure (excluding Interest Payments on Public Debt)

25. Under the program, central government primary current expenditure is defined as the sum of central government expenditure on: (i) personnel wages and salaries; (ii) goods and services; (iii) transfers and subsidies; (iv) other unallocated current expenditure[3].

I. Indicative Floor on Social Expenditures

26. Social **expenditures** are defined as capital expenditures (development expenditures) on education, health, social transfers to needy families, the AMEL employment training program (and university scholarships), UTSS indemnities, family allocation as well as development expenditures of the Ministry of Women and Family Affairs, Youth and Sports and Social Affairs; all current expenditures ("dépenses de gestion") of the above-mentioned sectors and programs, as well as food and energy subsidies, are excluded.

[3] The methodologies used to measure current expenditure categories for the central government are those used to design the table of central government financial operations presented in the macroeconomic framework.

Program Assumptions on Adjustment Factors for Quantitative Performance Criteria (Millions of US dollars)					
	2014				
	2014 Q1	2014 Q2	2014 Q3	2014 Q4	Year
Government External Financing	**803.6**	**855.4**	**676.9**	**1828.7**	**4164.6**
Project loans	74.4	108.4	58.8	114.1	355.8
Multilateral donors	507.5	738.0	603.4	600.4	2449.3
AMF (Arab Monetary Fund)	0.0	43.4	0.0	0.0	43.4
IMF (budget support)	507.5	444.6	220.9	220.9	1393.9
World Bank Group	0.0	250.0	250.0	250.0	750.0
European Union	0.0	0.0	132.5	129.6	262.1
Bilateral donors	200.0	0.0	0.0	0.0	200.0
Turkish loan	200.0	0.0	0.0	0.0	200.0
Financial Market Access	21.7	9.0	14.7	1114.1	1159.5
Sukuk	0.0	0.0	0.0	500.0	500.0
Market Financ. (with possible Japanse guarantee)	0.0	0.0	0.0	300.0	300.0
Market Financ. (with possible US Treasury guarantee)	0.0	0.0	0.0	300.0	300.0
Other (incl. Loan Transfers to SOEs)	21.7	9.0	14.7	14.1	59.5
Budget Grant	**20.7**	**13.8**	**27.6**	**75.8**	**137.9**
Privatization Receipts	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Government External Debt Service	**213.5**	**302.7**	**202.2**	**249.9**	**968.3**
Amortization	118.9	196.3	114.1	185.7	615.1
Interest	94.5	106.4	88.1	64.2	353.2
Resident deposits at the BCT 1/					

Sources: Tunisian authorities and IMF staff estimates

1/ End December 2013 is the reference level and was estimated at USD 1,852.07 million

J. Adjustment Factors for the Program Performance Criteria

27. The **NIR** targets are adjusted upward (downward) if the cumulative sum of net external financing of the central government (excluding project loans and any access to capital markets), the sum of budgetary grants, privatization receipts received in foreign currency, the increase (decrease) in the residents' foreign currency deposits at the CBT are greater (lower) than the levels indicated in the table below. The NIR targets will be also adjusted upward (downward) if the total amount of cash payments on external debt service of the government is greater (lower) than the levels included in the table below.

28. The net **domestic assets (NDA)** targets will be adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the cumulative sum of net external financing of the central government (excluding project loans and any access to capital markets), the sum of budgetary grants, privatization receipts received in foreign currency, the increase (decrease) in residents' foreign currency deposits at the CBT are lower (greater) than the levels indicated in the following table. The NDA targets are also adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the total amount of cash payments on external debt service are greater (lower) than the levels included in the table below. The NDA ceiling will be converted into Tunisian dinars at the program exchange rate.

29. The ceilings on the **NDA of the CBT** will also be adjusted downward or upward based on the amount of CBT reserves released/mobilized because of a possible decrease/increase in the reserve requirement.

30. The floor on the **primary balance of the central government**, excluding grants, will be adjusted upward/downward based on the amount used to recapitalize the public banks. The recapitalization amounts for 2013 are assumed to be 500 million dinars (Q4 2013).

K. Monitoring and Reporting Requirements

31. Performance under the program will be monitored using data supplied to the IMF by the Tunisian authorities as outlined in the table below, consistent with the program definitions above. The authorities will promptly transmit to the IMF staff any data revisions.

INFORMATION TO BE REPORTED IN THE CONTEXT OF THE PROGRAM

Type of Data and Description	*Periodicity* *Weekly (w)* *Monthly (m)* *Quarterly (q)*	*Delay in days*
GDP: Supply and demand at current, constant, and the previous year's prices, including sectoral indices.	*q*	*45*
Inflation: Including the underlying inflation of non-administered and administered prices.	*m*	*14*
Fiscal Sector		
Tax and nontax revenue of the central government decomposed on the basis of main tax and nontax revenues items	*m*	*30*
Total expenditures: current and capital, transfers and subsidies.	*m*	*30*
Capital expenditure: by type of financing: domestic and external (differentiating loans and grants), and by main sectors and projects (agriculture, social, infrastructure).	*m*	*45*
Current expenditure: by type of expenditure: wages, goods and services, transfers.	*m*	*45*
Social expenditure	*q*	*45*
Domestic and foreign debt		
Stock of domestic and foreign debt: of the central government and debt guaranteed by the government, with breakdown by instrument and type of currency (in dinars and foreign currency with the equivalent in domestic currency).	*q*	*30*
Stock of domestic arrears as per TMU, as well the stock of accounts payable that correspond to expenditures committed/ payment ordered more than 90 days before (and by	*q*	*45*

type of expenditures),		
Disbursement of foreign loans: Breakdown into project loans and budgetary loans by principal donor and identifying the most important projects to be financed in the original currency and its equivalent in Tunisian dinars converted at the current exchange rate at the time of each transaction. **Domestic borrowing from banks and nonbanks:** including bonds, Treasury bills, and other issued securities.	*m*	*30*
Debt guaranteed by the government: by instrument and type of currency (in dinars and in foreign currencies and its equivalent in national currency) **External and domestic debt service:** amortization and interest.	*m*	*60*
External payment arrears: external debt contracted and guaranteed by the government.	*q*	*30*
Debt rescheduling: possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	*q*	*45*
Consolidated accounts of the central government at the CBT: The stock of deposits will be broken down as follows: (i) Treasury current account; (ii) special account of the Tunisian government in foreign currency and its equivalent in dinars; (iii) miscellaneous dinar accounts; (iv) loan accounts; (v) grant accounts; (vi) FONAPRA-FOPRODI accounts; and (vii) accounts pending adjustment (including privatization receipts from Tunisia Telecom).	*m*	*30*
External Sector		
Imports of Petroleum Products: average import price of main petroleum products.	*m*	*30*
Foreign trade: imports and exports of goods, including volumes and prices, by sector.	*m*	*30*
Deposits: Stock of foreign currency deposits, according to the residence of the holder.	*m*	*14*
External debt:	*q*	*30*

Debt service (amortization and interest) of institutional agents by instrument and at type of currency (in foreign currency and its equivalent in dinars). Stock of external debt of institutional agents by instrument and type of currency (in foreign currency and its equivalent in dinars) (in conformity with our obligations under SDDS). Overall net external position of Tunisia (preliminary). Overall gross external debt position Overall net external position of Tunisia (in conformity with our obligations under SDDS).	*m* *q* *q* *q* *A*	*30* *90* *90* *90* *180*
Balance of payments: Prepared by the CBT	*q*	*30*
Monetary and Financial Sector		
CBT accounts at the current exchange rate: detailed table including the monetary system.	*m*	*30*
CBT accounts at the program exchange rate: Including net international reserves.	*m*	*30*
Foreign exchange market operations, Interbank market, retail market and wire transfers for CBT purchases on the retail market: CBT spot sales and purchases on the foreign exchange market, , stock of CBT currency swap (provide details on direction of transactions (TND/FX or FX/TND), amounts of principal, spot exchange rate in swaps agreement, interest rate applied on FX counterpart), detailed information on other BCT's forward foreign exchange operations, including outright forward sales of Tunisian Dinar . The terms and conditions of any new transactions (including the extension or renewal of existing terms and conditions) will also be provided. CBT foreign exchange reserves, breakdown by currency and by instrument, and the institutions where such reserves are held.	*m*	*30*
Banks' financial soundness ratios: Indicators of financial soundness and regulatory capital adequacy ratios of the banking system, including the quality of assets and the profitability of banks. The indication of the different banks is optional.	*m*	*30*

Direct refinancing of commercial banks by the CBT: Breakdown by bank.	*m*	*14*
Interest rates: Deposit rates, interbank rates, and lending rates.	*w*	*14*
NPLs: Stock of banking sector NPLs, and breakdown by commercial banks.	*q*	*60*
Balance sheets of commercial banks, including detailed income statements, in accordance with “Uniform Bank Performance Reporting” agreed with Fund staff.	*q*	*60*
Other information to be reported		
Information on Fiscal, Monetary, and Financial Policy: Decrees or circulars newly adopted or revised concerning changes in tax policy, tax administration, foreign exchange market regulations, and banking regulations. A copy of official notices of changes in gas and electricity rates and any other surcharge (automatic or structural), as well as the prices of petroleum products and levies/surcharges on gas and petroleum.	*d*	*3*