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

January 28, 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.

Tunis, January 28, 2014

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

Dear Madame Lagarde:

1. The political transition process towards new elections is moving forward again. After having experienced during the past few months one of the most difficult periods in our democratic transition process, Tunisia has once again re-established a clear political roadmap. Thanks to the efforts of all political parties and from civil society that were part of the "National Dialogue," a consensual solution was found in which a new apolitical government is emerging, members of the electoral commission (ISIE) have been nominated, and a new constitution is to be adopted before the end of January. We remain convinced that these developments will pave the way for free and democratic elections that will return Tunisia back on the path to strong and sustained economic growth.

2. The different steps of the political transition process—combined with exogenous shocks—had a negative impact on the implementation of the government's economic program. Moreover, a difficult international economic environment—together with less financial support from our development partners than originally envisaged—increased the pressures on the external and fiscal position. These developments—coupled with unprecedented security tensions—dampened, despite our best efforts, Tunisia's short-term economic outlook through weaker economic activity and a slower pace of reforms.

3. Despite these unfavorable circumstances, our economy was able to withstand these shocks, allowing us to meet most of our program targets through September 2013. Our quantitative performance criteria (PC) for end-December Net Domestic Assets (NDA) and Net International Reserves (NIR) appear to have been missed because of lower external financing and higher banking liquidity needs, while the PC for the primary balances was met::

- *Performance criteria and quantitative indicators*. We met the quantitative criteria on net international reserves (NIR) and net domestic assets (NDA) for end-June and end-September, and met the continuous zero ceiling on accumulating external arrears. Our end-December NIR and NDA criteria appear to have been missed because of lower external market financing and high liquidity needs in the banking sector. The performance criterion on the primary balance of the central government (cash basis) at end-December appears to have been met, because of : (i) measures stopping all current expenditure commitments effective December 15, 2013, except with regard to wages and debt interest; (ii) shortening the complementary period for 2013 to January 20; and (iii) delays in mobilizing external resources leading to liquidity constraints that deferred some payments scheduled for end 2013 to early 2014. The quantitative indicative target for social expenditures appears to have been missed for all test dates owing to implementation constraints, although social spending and the amount of transfers to needy households was close to levels in the revised budget law. The continuous indicative target on no accumulation of domestic arrears was met.

- *Structural reforms*. Despite some delays in their implementation, nine of the fourteen structural benchmarks established for implementation by end-December 2013 were attained (Table 2a). The new targeted household support program to accompany the reduction of energy subsidies and protect society's most vulnerable segments, slated for end-August, will only be ready by March 2014 given the need to identify the proper mechanism to reach the targeted group. Administrative procedures have delayed the audit of public enterprises, for which we have broadened coverage to one more public enterprise, and intend to complete by end-March 2014.. All monetary policy and financial sector benchmarks were met, with the exception of the benchmarks on: (i) the liquidity ratio which will be ready by end-January 2014; (ii) the interconnecting banking platform and market maker agreement; which was delayed by technical difficulties; and (iii) the preparation of the strategic orientation for public banks, which could not be observed because of delays in the audit firm selection process. The structural benchmarks on reducing the corporate tax dichotomy, merging the functions of the Large Taxpayer Unit, and the automatic fuel pricing formula were all met, albeit with a slight delay. As to the investment code, the project was approved in November 2013 by the Council of Ministers and submitted to the National Constituent Assembly for ratification. The relevant implementing decrees will be drawn up and published as soon as the code is ratified.

- In view of the appropriate policies taken to attain the main program objectives set for the first nine months of 2013, and of the strong progress in implementing our ambitious structural reform agenda through December (Tables 1 and 2a), the government requests conclusion of the first and second reviews of the program supported by the stand-by arrangement as well as the disbursement of SDR 329.12 million. In light of the corrective actions taken, the government also requests waivers for nonobservance of the end-December quantitative performance criteria on the NIR and NDA and a waiver of applicability on the performance criterion on the primary fiscal balance, which appears to have been met, but for which final data is not yet available. The government also proposes new performance criteria for end-March 2014 and end-June 2014, new indicative targets for 2014 end-September and end-December as well as a new indicative target for primary current expenditure, as described in the MEFP (Table 1) and the attached Technical Memorandum of Understanding. Over the next few months, and to provide more flexibility to meet the program objectives, the government also intends to discuss with staff in the next review the possibility of additional fiscal measures or for rephasing/extending the arrangement.

4. This Letter of Intent is based on the preceding Letter of Intent (LOI) and the Memorandum of Economic and Financial Policies (MEFP) dated May 24, 2013. The attached MEFP outlines the main components of the government's program and the policies of the Central Bank of Tunisia, which we plan to implement in 2014. It also describes the structural reforms and indicators for the second year of the program. We are determined to implement our program diligently, notwithstanding the difficulties we face in the domestic, regional, and international context.

5. We are confident that the policies described in the attached MEFP are appropriate for achieving the objectives of our economic program, which aim at addressing short-term stabilization goals while laying foundations to support growth and protect the vulnerable. We will remain vigilant and stand ready to take any additional measure that may be necessary to attain those 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 IMF staff to publish this Letter of Intent and its attachments (MEFP, Tables 1 and 2a and 2b), as well as the related staff report.

Sincerely yours,

/s/ /s/

Chedly Ayari
Governor of the Central Bank of Tunisia

Hakim Ben Hammouda
Minister of Finance

Attachment I. Memorandum of Economic and Financial Policies

Tunisia is coping with an external environment marked by the economic crisis in our principal partner countries and a particularly difficult transition to democracy, striving to achieve progress through dialogue and consensus. This has resulted in an economic slowdown that has narrowed our scope for fiscal and external flexibility. To meet those challenges and keep our fiscal and international reserve positions at sustainable levels, we have initiated a process aimed at containing current expenditures, further tightened monetary policy, maintained a more flexible exchange rate along with measures to ensure stricter enforcement of existing regulations, and implemented reforms aimed at strengthening the banking sector and its regulatory framework. We remain committed to promoting a competitive private sector capable of sustaining inclusive growth, while taking the measures necessary to preserve social cohesion and protect vulnerable population groups.

Macroeconomic Context and Outlook

1. **Several exogenous shocks and difficulties in the transition to democracy have created severe challenges for the Tunisian economy.** The lengthy consultation process to complete the political transition—and the unprecedented upsurge of insecurity— have shaken confidence in the Tunisian economy. This has led to a slowdown in economic growth, a delay in the implementation of planned reforms, and persistence of the wait-and-see attitude of local and foreign investors. In addition, new exogenous shocks have occurred, such as the reduced volume of Algerian natural gas headed to Italy and transiting through Tunisia, which has increased the national economy's dependence on foreign sources of energy and led to a hike in budget subsidies through additional energy imports in the first quarter of 2013. Moreover, the financing necessary to support the Tunisian budget, as well as funds to be mobilized through external financial markets, did not materialize as programmed.

2. **Despite the difficult international economic environment and national context, Tunisia's macroeconomic performance remains generally positive.** Economic growth for 2013 remains below the initial forecasts of 4 percent but will still be close to 2.7 percent year-on-year—driven by private and public services and despite a decline in agribusiness and stagnation in manufacturing. After reaching 6.5 percent year-on-year in March 2013, overall CPI inflation fell to 6 percent at end-2013, primarily as a result of the slowdown in the increase in food prices and weak credit to the private sector (6.8 percent year-on-year at end-December 2013). Despite lower-than-expected volumes of imported capital goods and raw materials, weak tourism receipts and workers' remittances, combined with depressed external demand for Tunisian goods and lower dividend transfers for telecom company Tunisiana (about DT500 million), are expected to keep the current account deficit in 2013 at 8.2 percent of GDP, which is the same level as in 2012 but higher than the initial projection under the program (7.5 percent of GDP). This deterioration of the external position was financed by foreign direct investments, a deposit from the Qatar National Bank, and a new commercial line of credit granted to the Central Bank of Tunisia, which helped ease the impact of

lower-than-forecast budget support and helped the overall balance of payments to remain consistent with the projections under the program.

3. **The economic program and reforms will be based on the following macroeconomic framework:**

- **Growth.** For 2014, the Tunisian government still expects 4 percent growth for the year as a possibility, but to be prudent—and considering the uncertainties associated with the political transition, the postponement of elections, and a still-difficult international situation—the macroeconomic program was based on a growth rate of 3.0 percent year-on-year (compared to 4.5 percent under the initial program approved in June 2013). The prospects for growth should improve after the elections, particularly during the second half of 2014, which will considerably reduce the uncertainty and wait-and-see attitude on the part of economic operators, thus allowing growth to exceed the potential in 2015 and reduce the negative output gap.

- **Inflation.** Inflationary pressures should continue to diminish in 2014, reaching 5.3 percent at the end of the year. A prudent monetary policy will reinforce the Central Bank's credibility and further anchor inflationary expectations.

- **External position:** In 2014 and over the medium term, the current account deficit should narrow to 5.5 percent of GDP by 2015, following the anticipated economic recovery in Tunisia's trading partners and lower international commodity prices.

Objectives and Performance under the Program

4. **The key objectives of our economic program and reform agenda remain unchanged: to preserve macroeconomic stability over the short term while laying the foundations for higher and more inclusive growth that protects the most vulnerable population groups.** Our program continues to revolve around the following three pillars:

- **Preserving macroeconomic stability.** We will continue to implement appropriate macroeconomic policies to reduce the vulnerabilities of our economy, particularly by containing current expenditures in 2014, and implementing a prudent monetary policy and more flexible exchange rate.

- **Laying the foundations for inclusive growth.** Our priorities are to reduce the banking sectors' significant vulnerabilities, improve the composition of the budget through fiscal and budgetary structural reforms, and adopt an ambitious program of structural reforms to improve the business climate and attract larger volumes of foreign direct investment.

- **Protecting vulnerable groups in the population** by strengthening social safety nets and proceeding with a systematic evaluation of the social impact of reforms.

A. Performance under the Program

5. The economic policies that have been implemented helped to offset the exogenous shocks that—according to our estimates—were the main contributors to not meeting the performance criteria at end-December. This will be confirmed during the third review when the data will become available (Tables 1 and 2a) :

- **The performance criterion for Net Domestic Assets (NDA) at end-December appears to have been missed,** although we met the criteria for June and September after application of adjustors related to residents' foreign currency deposits and the lower level of the government's external loans compared to the projections (particularly payments on a US$200 million loan granted by Turkey, which was postponed to Q1 2014). The NDA target for end-December appears to have been missed, primarily because of an increase in net credit to the government.

- **The performance criteria on net international reserves (NIR) at end-June and September were met but will fall far short of the targets at end-December 2013.** For the year as a whole, lower official budgetary loans and the delayed issuance of sukuks—as well as significant interventions on the foreign exchange market in response to needs for current account transactions—could not be offset by the 300 million euro commercial line of credit and a $500 million deposit from the Qatar National Bank granted to the Central Bank of Tunisia. These amounts also increased the CBT's external liabilities, resulting in a decline in Net International Reserves (NIR) to $5.5 billion at end-December 2013, compared to an adjusted target of $7.1 billion. Gross international reserves at end-December 2013 will cover the three months of imports which we consider as our minimum threshold.

- **The performance criterion for the central government's primary balance (on a cash basis) was missed for end-June and end-September, but appears to have been met for end-December.** The fiscal stance deteriorated through end-September due to higher energy subsidies (0.6 percent) as well as additional expenditures corresponding to the budget for 2012, but paid for during the complementary period (extended to April 2013). However, this was reversed by end-year, with the end-December primary fiscal deficit estimated at 2.6 percent of GDP (on a cash basis, excluding grants and privatization revenues) relative to 4.9 percent under the program (after adjustments for banking recapitalization), most because of deferred cash payments from 2013 to 2014 (about 3.2 percent of GDP). Savings in wages and social spending (about 0.6 percent of GDP) at the end of the year and an under-execution of capital spending (about 1.5 percent of GDP lower than programmed)—associated with constraints on absorption capacity at the regional level and procurement procedures rather than a deliberate decision to reduce development expenditures—also help explain this performance, which was obtained in an environment of scarce external financing. On the tax front, our efforts to collect tax arrears and dividends from public enterprises helped offset lower weaker indirect taxation.

- **The indicative target for social expenditures has been missed for all test dates,** due to capacity constraints, although social spending and the amount of transfers to needy households was close to levels in the revised budget law.

6. **We have combined our macroeconomic policies with the implementation of an ambitious structural reform agenda in the following areas:**

- **Monetary and foreign exchange policy.** Considerable progress has been made thanks to the adoption of new measures with respect to collateral requirements in refinancing operations for the banks. Technical problems have delayed the implementation of the electronic platform which will allow interlinking with banks, and the adoption of the Market Makers Agreement. This measure, necessary for the introduction of a system of weekly foreign currency auctions will be completed by mid-March 2014 (new structural benchmark).

- **The financial sector**. We have set up the architecture of the new reporting system, completed the inspection reports of five banks as provided under the program, and prepared an impact study on the new liquidity ratio that we will present to the Bank's Board of Directors in January 2014. As for the strategic approach the government plans to take to reduce the weaknesses of the public banks, the solution is contingent upon completing the audit work on the three major public banks—related work has been delayed due to constraints in the procurement procedures for selecting the auditing firms. So far, the interim audits on two public banks have been completed and we anticipate the new business strategy to be defined by March 2014 (new structural benchmark).

- **Government finances.** Halving the difference in the corporate income tax (CIT) rate between the onshore and offshore sectors, and other related compensatory measures, were included in the government's budget for 2014. We have also merged the tax units within the Directorate of Large Companies, and designed a new automatic fuel price formula. As for the audits of public enterprises, we have initiated the audit of an additional enterprise and we plan to complete this work by March 2014. The new household support program to protect the most vulnerable groups in the population from a reduction in energy subsidies will be finalized by March 2014 due to needed delays for determining the right targeting mechanism.

- **Development of the private sector**. The new investment code, recently adopted by the government as agreed under the program, has been submitted to the National Constituent Assembly for approval and will later be supplemented by implementation decrees aiming at defining market access and restrictions on investments.

B. Short-term Objectives: Reestablishing Fiscal and External Buffers

Fiscal policy

7. **We made a firm commitment to reduce the pressures on the government's budget that arose in 2013 and considerably reduced the available cash flow buffers.** Thus, we kept the wage bill for 2013 at the budgeted level, and made savings on non-allocated expenditures in 2013 (0.1 percent of GDP). We also limited the complementary period by stopping commitments earlier than usual, through a circular sent to ministries by December 15, 2013. Excluded from this measure are commitments related to salaries, and capital expenditures that could stop later in the year. For more transparency, the supplementary budget law, which has just been adopted by Parliament, also accounted for the repayment of outstanding arrears (1.2 percent of GDP), which is done before the end of the year 2013.

8. **A rebalancing toward more fiscal consolidation was initiated under the 2014 budget law while protecting priority and development expenditures.** We are firmly committed to rebalancing our fiscal policy by maintaining the structural budget balance—excluding the effects associated with the economic cycle and one-off operations, such as bank recapitalization requirements or arrears repayment—at the same level as 2012, or 5.2 percent of GDP. The government's 2014 budget also incorporates significant measures in the area of social equity—such as increasing the tax exemption threshold for the poorest groups in the population and the tax exemption with respect to gains on land sales associated with the social housing program. We also plan to increase capital expenditures by about 15 percent compared to 2013.

9. **The measures recommended to reduce the fiscal deficit are included within a framework of medium-term reforms aiming at reducing vulnerabilities through:**

- **Revenue mobilization.** While awaiting the comprehensive tax reform, we included new measures in the budget law intended to: (ii) reduce some tax exemptions on customs duties and the VAT (gain of 0.05percent of GDP); (iii) introduce new taxes on the sale of properties and secondary residences (0.16 percent of GDP); (iv) increase the minimum tax from 0.1 percent to 0.2 percent on domestic turnover (0.04 percent of GDP); (v) remove the ceiling on royalties of 1 percent on salaries (0.02 percent of GDP); and (vi) regulate cash transactions. We have also decided to strengthen control of the forfeit system, including for the liberal professions, using the data available in the social insurance system and banking system (as permitted by current law). Moreover, we took measures to fight tax evasion including through streamlining cash commercial operations.

- **Reform of energy subsidies.** Our subsidy reform strategy rests on several pillars involving short- and medium-term measures.

    - For 2014, and in conjunction with the implementation of the strategy for reducing the country's energy deficit, the 2014 budget law has included savings valued at 650 million dinars on energy subsidies. To this end, we have reduced as of

January 1st electricity subsidies intended to cement companies, and intend to completely eliminate them for these companies as of June 2014. We also plan to proceed with a gradual adjustment of energy tariffs/prices that consist of keeping the social rate for the most disadvantaged segments of the population and creating new consumer tranches at prices that act as a deterrent, so as to gradually lighten the weight of subsidies and encourage energy savings. The implementation of this reform—which is supposed to generate DT 550 millions—has already led to a 10 percent increase in tariff rates and gas prices of some clients by 10 percent as of January 2014 (for clients in high, medium, and low voltage), except for those who consume less than 100kwh whose rates will be preserved. In addition, fuel prices will be increased by around 6 percent on July 1, 2014, which will allow us to obtain our remaining savings in energy savings for the year (i.e., DT 100 millions).

- We have also adopted a new formula for automatic determination of fuel prices, which will adjust gasoline prices by 0.1 dinar/liter once international prices have a cumulative increase of DT 10 per barrel (i.e., 0.67 dinar/liter) in a quarter. This formula will ensure that the budgetary envelope will not be affected in the event of a large increase in international prices. Meanwhile, we will continue assessing a sustainable formula that can introduce a smoothing system that will allow fuel prices to be aligned with international prices.

- Fuel price adjustment will be accompanied by the implementation of social programs already included in the government's budget and the implementation of an Energy Transition Fund for all energy-saving actions and for the development of renewable energy.

- **Control of the wage bill.** The salary freeze announced for 2014 will allow the country to contain the increase in the wage bill at 12.4 percent of GDP. However, this will still represent an 8 percent increase due to new hiring scheduled since 2011 and the full year effect of new hiring in 2012–13. In the short term, by the end of March 2014, we will conduct an audit of the payroll management system—an exercise that we expect to carry out every year. We also plan to proceed with an evaluation of the civil service hiring system, seeking better alignment between qualification requirements and the structure of government salaries. To this effect, a draft project will be submitted to the Council of Ministers in June 2014. Subsequently, the control of hiring in the context of civil service reform will be crucial for reducing the weight of salaries in the government's budget.

10. **Additional measures not included in the government's budget are needed to maintain the structural deficit constant relative to 2012.** In that context, we are committed to significantly reducing non-allocated expenditures included in the government's budget, of about 0.5 percent of GDP (with one-third coming from current expenditures). We also remain committed to taking additional measures to correct for any deviation from the budget target, including through limiting current expenditures—goods and services, subsidies and transfers—that have in the past been a

source of budget overruns. To this end, a benchmark ceiling on primary current expenditures will be part of the indicative targets included under the program (Table 1). Priority social and investment expenditures will be preserved, and will not be cut as part of the fiscal consolidation strategy.

Monetary and foreign exchange policy

11. **The structural liquidity deficit has increased pushing the CBT to increase its intervention in the monetary markets to respond to bank liquidity requirements.** Thus, CBT refinancing went from 3 billion dinars in March 2013 to nearly 4.6 billion dinars in December 2013 (one billion dinars of which was an outright purchase of government bonds on the secondary market—OMOs). We still maintain a prudent monetary policy, since this refinancing—while higher than in earlier months—is still lower than the demand coming from banks, which depends on the level of foreign exchange operations, Treasury bill purchases, and financing of the overdrafts of some public enterprises. However, very little of this demand is linked to increased credit to the private sector, which remains anemic due to healthy companies' very limited interest in increasing their productive investments, and owing to the regulatory ceiling on lending rates granted by the banks, which does not encourage the financing of high-risk investments such as SMEs.

12. **Although the objective of monetary policy continues to be controlling inflation while ensuring a healthy credit growth to the private sector, the pressures generated by external imbalances argue for the introduction of a more prudent monetary policy.** As a result, we have decided to take the following measures:

- **Increase the policy rate by 50 basis points.** Such an adjustment—combined with the introduction of a 25 basis points symmetrical corridor around the policy rate—will help to normalize the current situation by bringing the policy rate closer to the money market rate (nearly 4.75 percent, or the credit facility rate) and thus reduce, although only partially, the negative interest rate (with the inflation rate at 6 percent), facilitating a better allocation of productive resources. Moreover, we stand ready to raise this rate further to contain any additional inflationary pressure caused by an accommodating fiscal policy and/or a rapid depreciation of the exchange rate.

- **Modify the excessive borrowing rate by removing the ceiling for loans to businesses and increasing it for loans to private consumers.** In March 2013 we eliminated the ceiling on deposit rates for term deposits that had been introduced in December 2011. We expect to do the same with regard to lending rates by amending the legislation on the excessive interest rate, which will be eliminated for companies and initially increased for individuals. This will allow the banks to mobilize more deposits without harming their profitability margins and to apply a higher interest rate to high-risk clients, thus improving monetary policy transmission channels. To this end, an impact study—to be conducted with World Bank TA— will be finalized by March 2014 (structural benchmark).

13. **The CBT's monetary policy continues to hold to its gradual strategy of reducing liquidity injections, which will allow the banks to better manage their liquidity and minimize the risks to the CBT's balance sheet.** To this end, we have tried to reduce the structural liquidity deficit by reducing the reserve requirement rate by 100 basis points and abandoning the current rule that penalizes banks that do not meet the liquidity ratio by imposing an automatic and proportional increase in their required reserves. At the same time, we have limited the banks' dependence on CBT refinancing, by increasing the share of refinancing guaranteed by government securities (10 percent at end-August 2013; 20 percent at end-December 2013) and introducing a 10 percent haircut on loans accepted as collateral as of January 1, 2014. In order to further reduce these injections and better manage risks, we plan to:

- Increase to 40 percent by December 2014 (new structural benchmark), the share of government securities used as collateral in the CBT's refinancing operations. A study on the possibility of valuing government securities at market prices and not at their nominal value will be conducted by September 2014.

- Revise the haircut system on loans according to a differentiation based on past nonperforming loans, which would correspond to a haircut rate of about 25 percent. Exhaustive preparatory work was done and the new haircut rate will be introduced as of June 2014 (structural benchmark).

- Implement a "lender of last resort" facility for solvent but illiquid banks. This facility (end-June structural benchmark) should include significant penalties, and a bank that requires emergency liquidity must submit a plan to reestablish its liquidity position, with restrictions imposed on new loans and dividend payments suspended for a certain period of time. IMF technical assistance in Q1 2014 is requested to help develop this project.

14. **In recent months, the depreciation of the dinar has reduced the overvaluation of the exchange rate to a moderate level.** We intervened in May to calm pressures on the exchange market in a context marked by a high volume of current account transactions and delays in the disbursement of external financing. Despite these interventions, the exchange rate depreciated by about 9.5 percent against the euro and 5.8 percent against the dollar during the course of the year, which helped to bring back to 5 percent the estimated overvaluation of the exchange rate, according to IMF evaluations. However, the current context, marked by limited external flows (whether from private capital or foreign assistance), negative interest rates, and a fiscal policy that has at times been more accommodating than expected, will increase pressures on the foreign exchange market. To address these pressures, in addition to more restrictive budgetary and monetary policies, we plan to:

- Continue to further limit the CBT's interventions in the foreign exchange market to smoothing excessive exchange rate fluctuations, while ensuring the smooth processing of foreign payments.

- *Introduce swap operations between the CBT and commercial banks* in the monetary market, as of January 1st, 2014. This will allow banks with excess FX to obtain Tunisian dinars, and vice versa. This measure will also help strengthen the monetary policy framework and allow for a better management of banking liquidity. All prudential norms on FX positions will be respected by all participant banks.

- Promulgate as of October 2013 a circular that seeks to implement current regulations on those holding accounts in foreign currency, imposing ex post controls on the use of funds from accounts in foreign currency and requiring banks to make any operation to purchase foreign currency for someone holding a foreign currency account contingent on that person's not having additional liquid foreign currency in that account.

- Accelerate the introduction of external mechanisms needed to introduce weekly foreign exchange auctions, starting in 2014. In this context, the Market Makers Agreement and the electronic platform will take effect as of March 2014 (structural benchmark at end-October 2013). After that, we plan to introduce a weekly foreign currency auction mechanism before the end of 2014. This would allow us to control the volume of foreign currency sales while allowing the exchange rate to adjust freely. However, a prerequisite to the introduction of an auction mechanism is the introduction of an efficient information system that will allow the CBT to centralize the flow of projected foreign currency payments. To this end, we request IMF assistance to improve the quality of projections on foreign currency flows.

15. **Our development strategy will remain open and based on free trade.** Consistent with World Trade Organization rules, we will only introduce new restrictions or surcharges on imports as a last resort, after having exhausted market solutions that preserve appropriate incentives, and only with very clear and pre-announced phase-out criteria.

C. Laying the Foundations for Inclusive Growth

Financial sector policies

16. **To address the vulnerabilities in the banking sector, we have launched a comprehensive set of reforms.** Here our specific focus was on aligning banking practices with international standards and strengthening bank supervision. The reforms allowed for: (i) the introduction of collective provisioning to improve risk coverage and financial buffers (although the provisioning rate remains low at about 47 percent after suspended interests); (ii) the tightening of standards on the division and risk concentration ratios, which took effect as of end-2013; (iii) a gradual increase in the capital adequacy ratio from 8 percent to 9 percent at end-2013 and 10 percent at end-2013, with a Tier 1 ratio set at 6 percent at end-2013 and 7 percent at end-2014; (iv) the introduction of a circular intended to improve the governance of credit institutions; and (v) further raising risk coverage to levels seen in similar countries by introducing a new haircut for non performing loans that are older than 3 years— that go from 40 percent higher provisioning for NPLs of 3 to 5 years, 70 percent for those assets that are 6 to 7 years old; and 100 percent for assets of 8 years or more In order to improve transparency regarding the banking sector's situation, we have

prepared and published an annual report on bank supervision—an exercise we plan to carry out every year.

17. **We plan to continue with the reform of the financial sector in order to further reduce its vulnerabilities**. Reforms will aim to ensure that the banking system plays its proper financial intermediation role, including proper credit allocation and strict monitoring of credit, liquidity, and solvency risks. To that end, our strategy will center on the following actions:

- **Tackling the fragilities of public banks.** The interim audit reports on the public banks were completed before the end of 2013 for two of the banks, and will be completed in March 2014 for the third public bank. Given the procedural delay in initiating the public banks' audits, we will only be able to make a decision on the government's strategic role in this area in March 2014 (structural benchmark report of September 2013). In the meantime, however, and to prevent the public banks' situation from deteriorating further, we have introduced the following actions:

  - Adoption of a uniform criterion for loan analysis and prudent evaluation of collateral for the audits of public banks;

  - *Publication in December 2013* of a decree strengthening the governance of public banks by excluding them from the scope of the law governing public enterprises, so that they are subject to the same rules as private banks. Among other things, this will allow the management of public banks to include senior banking staff and boards of directors with skills coming from the private sector.

  - *Inclusion in bank restructuring costs* of a second tranche of 0.6 percent of GDP, in the 2014 budget law, in addition to the 0.6 percent of GDP included in the 2013 supplementary budget law; but that will only be paid in 2014 once the banks' audits are completed. These amounts are still lower than what is needed for the possible recapitalization of the public banks, which, according to FSSA estimates, could be about 2.6 percent of GDP. As a result, the costs of bank recapitalization may be reduced or increased under a supplementary budget law, based on the strategic orientation chosen and the results of the audits that will propose a series of potential solutions: recapitalization, merger, or reduction of the government's share, including through public-private partnerships. Bank recapitalization needs for 2014 will be financed through the issuance of non-marketable Treasury bills—with medium-term maturities—with the exception of additional requirements to finance the Asset Management and Recovery Company (AMC). The use of these Treasury bills will increase the capital of the banks involved but not their refinancing capacity. These bills could be replaced by marketable securities once a restructuring plan for the banks is introduced.

- Create an asset management company responsible for removing from the banking system nonperforming loans in the tourism sector. These loans—representing one-fourth of total nonperforming loans, or the public banks' largest portfolio of nonperforming loans—have reached 54 percent in this sector. We have held several meetings regarding the AMC, and prepared and then submitted to a ministerial council a draft law on the creation of the new company. In view of the urgency of the situation in our tourism sector, we will endeavor to implement an AMC in June 2014, through (i) adoption of a draft law on the AMC—prepared thanks to technical assistance provided by the World Bank; (ii) adoption of clear and transparent governance rules combined with financial and operational autonomy; and (iii) implementation of a business plan on the financing model, the costs of which will be closely coordinated with any bank recapitalization program.

- Strengthen bank supervision and the transparency of the banking system. We are engaged in introducing a formal bank supervision system based on risks assessment and a related method that would determine the frequency and intensity of inspection missions. Moreover, since January 2013 we have begun to impose monetary and disciplinary sanctions on banks that are in breach of prudential standards. We are also firmly committed to:

  - *Improving the reporting of banking data*. With technical assistance from IMF staff, we have submitted the overall architecture of a new system of bank accounting, financial, and institutional data (structural benchmark), the introduction of which will be spread over one year (up to December 2014—new structural benchmark). In the interim, by March 2014 we plan to set up detailed quarterly data for the development of a Uniform Bank Performance Report for all commercial banks, available 60 days after the end of each quarter, that will facilitate risk monitoring and reconciliation with the data included in the information system (*centrale des risques*). To ensure continuous and regular monitoring, these data as well as all banking data received will be utilized jointly by the DGSB and the DGSF.

  - *Moving toward international prudential standards*, revising the liquidity ratio to include off-balance-sheet transactions, and adopting a more forward-looking approach, introducing prudential standards on a consolidated basis. An impact study on the new liquidity ratio is now being completed and will be submitted to the Central Bank's Board of Directors in January 2014 (structural benchmark at end-December 2013). We also plan to announce regulations to be introduced in September 2014 to strengthen the prudential standards: these will require banks to introduce an internal risk rating system for different client segments. In parallel, we are going to do an assessment on prudential regulations for credit to public enterprises so as to closely assess credit risks and the financial situation of banks. *Strengthening bank supervision capacity. Resourc*es in terms of new hiring—including IT specialists—were made available to the DGSB. Thanks to these new resources and other additional human resources that we plan to provide to the DGSB during the course of 2014, we will be in a position to accelerate our onsite inspection activities in 2014, in addition to the general inspection of a large local bank (a first since 2006) and four non-routine inspections on credit risks that we have just completed, the results of which will be submitted to the CBT Board of Directors in January 2014. The methodology for onsite and offsite inspection wil*l also be strengthened, including incre*ased interaction, with technical assistance from the IMF that will also allow us to improve the procedures used.

- **Introduce an improved crisis management and bank resolution regime.** A preliminary version of the new law on commercial bankruptcy was prepared, to modernize and simplify the process of restructuring companies and liquidating insolvent companies. We are determined that the new legislation on bankruptcy will define clear rules regarding the government's status as a preferred creditor, as well as on granting private creditors the right to vote on recovery plans. With assistance from the World Bank, we have also begun work on the bank deposit guarantee system, a project that could be implemented starting in June 2014. In the context of bank resolution, we also plan to:

    - *Clarify the existing regulatory framework with respect to banking management and crisis resolution.* For this purpose, and with the assistance of the IMF and the World Bank, we plan to conduct a study of Tunisian banking laws during the first half of 2014 and subsequently propose the necessary modifications to provide a solid regulatory framework with respect to banking management and crisis resolution, consistent with best international practices. This proposal will be submitted to the management of the BCT in June 2014.

18. **A draft law on the reform of the CBT will be submitted to the Board of Directors at the end of the first half of 2014**. Following recommendations of the CBT's safeguard assessment, the new law (end-June structural benchmark) will cover strengthening the independence of the CBT, improving its governance and methods for conducting external audits, and modernizing the audit and internal control functions.

Budgetary reforms

19. **A better composition of public expenditures will be needed to achieve a growth-supporting medium-term fiscal consolidation and restore fiscal space.** The gradual replacement of generalized subsidies with a better-targeted compensation system, and the control of the wage bill, will free up budget resources for higher social expenditures and growth-supporting public investments over the medium term. Our reforms will also seek to:

- Improve the equity, efficiency, and transparency of the tax system. This program will encompass several reforms:

    - *Tax policy*. Consultations on taxation at the national level were organized during the month of November 2013 to finalize the work of the different working groups on establishing a simpler and more equitable taxation system; this will be discussed at the national conferences planned for March 2014, from which will emerge a new tax code adopted by a Council of Ministers in September 2014 (structural benchmark).

In the context of comprehensive tax reform, we plan to revise the corporate income tax (CIT) to achieve gradual convergence in the onshore and offshore sectors over the next few years, and announce it according to a clear calendar in the context of the plan for adopting comprehensive reform. The convergence planned for 2014 was incorporated in the draft budget for that year, through a one-half reduction in the onshore/offshore difference in CIT taxes (structural benchmark at end-September 2013). Revising the favorable treatment reserved to re-investment, taxing earnings and income from export activities, and taxing dividends are some of the steps we plan to implement gradually to ensure that the impact on tax receipts will be neutral throughout the entire process of reform.

- ➢ *Tax administration.* A preliminary diagnosis of the current tax administration situation was done, with support from an IMF mission. Following this diagnosis, we brought together the control and recovery functions within a strengthened DGE (structural benchmark at end-September 2013); in the short term we plan to restructure all tax functions and reinforce the selectivity of controls by establishing targeted criteria and objectives. A program of reforms to modernize the tax administration will be adopted by the Ministry of Finance in March 2014 (structural benchmark). This plan will aim at implementing a unified fiscal administration and will strengthen control and evaluation mechanisms in customs administration.

- **Improve the management and performance of public enterprises.** The increasing losses of the public enterprises, primarily in transportation (Tunisair), trade (Grain Board), and energy (STEG, STIR) will be controlled by imposing stricter limitations on transfers to the appropriations included in the government's budget. To ensure higher transparency and strengthen governance of public enterprises, we also intend to simplify the existing system of cross-subsidies between companies, by having the STEG and STIR import directly their energy needs, instead of having to go through the petroleum company (ETAP). To avoid expensive bank penalties, the Ministry of Finance is committed to providing companies that have the benefit of subsidies for energy or food products with advances on budgeted appropriations in order to reduce these enterprises' bank borrowing (the share of public enterprises in total commercial loans has been reduced from 11.4 percent in January 2012 to 9.3 percent at end-September 2013). In order to better assess the challenges facing the sector, we plan:

  - ➢ To finalize the first audit reports of the three large public enterprises in the area of energy (STEG, STIR, ETAP) by March 2014 (structural benchmark) and to strengthen the control of these enterprises through *periodic monitoring* of the invoices sent to the offices of the Ministry of Finance.

  - ➢ To strengthen the monitoring of public enterprises by preparing, by March 2014, a consolidated balance sheet of the 20 largest public enterprises (end-March 2014 structural benchmark); these will also be classified by sector, allowing for a more accurate estimate of the real impact on the government's budget. A monitoring committee that brings together the DG of "Public Participation", the CBT's DGSF, and the Unit for Monitoring the Productivity of Public Enterprises and Institutions (Office of the Prime Minister) will be set up to produce a quarterly report on the financial situation and proposed reorganization of these enterprises.

➢ To improve the governance of these enterprises, particularly through an overhaul of the legislative framework in order to strengthen the role of the Board of Directors and establish audit committees, while improving the transparency of their operations with improved transmission of information and regular assessment of budgetary risks.

- **Strengthen the management of public expenditures.** In the short term, we are committed to consolidating the government's accounts, excluding special accounts for loan projects, in a Single Treasury Account (new structural benchmark for March 2014). This will allow for better knowledge of the government's financial situation and a better understanding of the gaps between the monetary data and budgetary data related to government financing. We are also committed to examining the exhaustiveness and quality of the budget documentation, and to developing a report on financial risks. Immediate efforts will focus on the preparation of a new budgetary nomenclature in line with international standards and the modernization of the methods for controlling commitments. Over the medium term, we are committed to an ambitious program of "budgetary management by objectives" which should lead to a revision of the organic law and to simplifying a priori and strengthening of ex-post controls.

- **Assess and improve the effectiveness of investment expenditures.** An assessment on the management of public investments, produced in collaboration with the World Bank, indicates the need to set up large scale high-return projects that could have a definite impact on disadvantaged regions. Moreover, we have simplified, improved, and considerably modernized the procurement procedures, consistent with the recommendations from the World Bank's technical assistance program, which will take effect in January 2014. This will allow for a more rapid and transparent revamping of investments. We have also undertaken procedures to strengthen 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 thus deferred to later years, is no longer the norm.

Structural reforms

20. **Our structural reform program focuses on improving the business climate and promoting a competitive private sector that can generate inclusive growth and reduce unemployment and regional disparities.** To this end, we have:

- **Adopted a new Investments Code in November 2013**—developed with technical assistance from the World Bank and following consultations with civil society and the donors. The code seeks to encourage private investments with the introduction of a more transparent and more effective regulatory framework and the rationalization of incentives. Its effective implementation remains dependent on new implementation decrees that will be ready by March 2014 (new structural benchmark) and will adhere to the principles of liberalized access to the markets, reduced restrictions on investment, simplification of the rules for repatriating capital, and the rationalization of exemptions. Moreover, the law on competition is being finalized and will reduce state intervention in the economy, relaxing excessive regulations, and strengthening competition among companies.

- **Accelerated our efforts toward simplification of administrative procedures**, in the area of taxation and customs, among others, in order to promote the private sector and limit the use of discretion in applying the regulations. To this end, following a report on the procedures to be simplified/eliminated in nine ministries, we have reduced restrictive administrative procedures for the private sector in the areas of transportation, customs, and exports and we are committed to continuing along this route, including for procedures related to the VAT.

21. **We are committed to reducing the obstacles to the proper functioning of the labor market.** To this end, we signed a new social contract on January 14, 2013 with employers and trade unions, which will serve as a common social roadmap. Agreement was reached on introducing a permanent council for tripartite social dialogue, as well as the establishment of an insurance fund to cover loss of employment for economic reasons. A broad consultation will be planned to discuss the new employment strategy now being prepared. The main priorities for the medium term will consist, in particular, of reforming the labor code to promote flexicurity in labor relations and to reduce the structural asymmetry of skills prevailing on the market.

22. **Aware of the crucial role of reliable statistical information and the monitoring of macroeconomic policies and implementation of social programs, we prepared a draft law that guarantees and protects the independence of the INS**. This law will be adopted by Parliament by March 2014. We will continue to expand on the regular publication of the results of surveys on economic conditions, employment, and household living conditions. In this context, we are engaged with EUROSTAT in a complete assessment of our statistics system, which will allow us to evaluate and improve its capacities. We also plan—with technical assistance from the IMF—to strengthen our institutional mechanism and the national accounts production system (particularly on the demand side), and the balance of payments system. The introduction of advanced and ongoing training in the area of statistics will make it possible to strengthen the statistical function within the various ministries.

D. Protection for the Most Vulnerable Groups

23. **We are determined that the pursuit of a budgetary consolidation and the introduction of reforms will fully take into account the impact of these reforms on vulnerable population groups, including strengthening of the social protection system.** In this context, in August 2012

we made the decision to create a new register of needy households in , which is an important and necessary step to ensure effective targeting ("leakages" to the non-poor in the existing systems are significant). In the interim, we are committed to implement a household supporting program. This program, initially planned for end-August 2013, will be operational in March 2014, which will allow us to better identify the targeted population and the distribution mechanism. The launch of this program will accompany the reduction in energy subsidies planned for this year. Following the projected increase in fuel prices and electricity rates on January 1, 2014 and other price increases planned for this year, the government has meanwhile included in the 2014 budget some social measures, such as a second social tariff to compensate poorer household for increases in electricity tariffs as well as a social housing program.

24. **The government continues to give absolute priority to the reform of the pension schemes.** The pension and health insurance systems are considered financially unsustainable over the long term. By 2018, and in the absence of any reform, the combined deficit could reach 2 percent of GDP. To address this risk, the Tunisian government has begun to analyze scenarios for reform of retirement and health insurance, in order to ensure the viability of the system. A decision on the reform to be followed will necessitate consultation to achieve national consensus, already initiated with the launch of the social pact in January 2013.

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

	Dec 2012	Mar 2013	Jun 2013				Set 2013				Dec 2013				Mar 2014	Jun 2014	Sep 2014	Dec 2014
		Cumulative Flows since the beginning of 2013													Cumulative Flows since the beginning of 2014			
		Actual	PC Program	PC w/ adjusters	Actual	PC Status	PC Program	PC w/ adjusters	Actual	PC Status	PC Program	PC w/ adjusters	Prel.	PC Status	PC	PC	IT	IT
Quantitative Performance criteria									(Millions of Tunisian Dinars)									
1. Floor on the primary balance of the central government (cash basis excl. grants)	-2,256	142	-37	-37	-264	Not Met	-532	-532	-1,308	Not met	-4,318	-3,818	-2,015	Met / TBC	-2,796	-3,119	-4,346	-5,960
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock)	-1,332	-1,757	-829	-97	-267	Met	-196	622	67	Met	-1,084	417	3,510	Not Met	3,952	4,662	2,981	1,603
									(Millions of US$)									
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock)	7,937	7,066	6,667	6,196	6,302	Met	6,751	6,224	6,267	Met	8,066	7,099	5,439	Not Met	5,308	5,086	6,452	7,501
Continuous Performance criteria									(Millions of Tunisian Dinars)									
4. Ceiling on the accumulation of new external debt payment arrears by the central government	...	0	0	0	0	Met	0	0	0		0		0		0	0	0	0
Quantitative Indicative Targets									(Millions of Tunisian Dinars)									
5. Ceiling on Current Primary Expenditure															4,253	8,432	12,922	17,845
6. Floor on Social Spending 3/	1505	207	794	794	618	Not met	1,191	1,191	957	Not Met	1,588		1,371	Not Met / TBC				
7. Ceiling on the accumulation of new domestic arrears	...	0	0	0	0	Met	0	0	0	Met	0		0	Met	0	0	0	0
Program assumptions on which adjusters are calculated in case of deviations																		
Disbursment of public external Financing on a cumulative basis (in US$ mill)		111	410		438		520		681		2,239		845					
Public debt service (interest and amortization) on a cumulative basis (in US$ mill.)		633	956		931		1,169		1,146		1,387		1,379		208.19	502.64	701.20	954.39
Bank recapitalization (in mln TD)											500		500					
Privatization receipts (in mln USD)	394	39	50		39		100		39		41		39		0	0	0	0
Resident deposits at the BCT (in mln USD) 4/	1,489	1,348			1,268				1,232				1,852					
Program exchange rate TD/ U.S. dollars	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/ At program exchange rat.

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.
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*	NOT MET. The templates for collecting needed data for conducting the impact study have been communicated to banks. This is expected to be completed by end-January 2014.
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. Thisbenchmark has now been pushed 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, becdause of technical delays. Work is ongoing and 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 circulaire has been adopted, and the SB will be met at the time of its implementation.
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: Proposed 2014 Structural Benchmarks

	Objective	Date
I. Financial sector		
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*	*Mar-14*
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*
Submission to the Central Bank Board of a draft Central Banking law in line with international practices.	*Financial sector stability*	*Jun-14*
Development and implementation of the new reporting system and bank classification system.	*Financial sector stability*	*Dec-14*
II. Fiscal policy		
Implementation by the Ministry of Finance of a plan to modernize tax administration.	Enhance Revenue Collection	Mar-14
Unification of government accounts into a Single Treasury Account (formulation to be revised for project loans)	Public Financial Management	Mar-14
Finalize the audit of the electricity company (STEG) and of the petroleum refinery company (STIR).	Lower fiscal risks	Mar-14
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
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*
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*
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*
Establishment of the lender of last resort facility	*Financial system stability and better crisis management*	*Jun-14*
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*

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 benchmarks are defined in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated January 23, 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 Finance, the Ministry of Development and International Cooperation, 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 Benchmarks

5. **The quantitative performance criteria and indicative benchmarks 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 benchmarks

- An indicative benchmark (ceiling) on total domestic arrears.
- An indicative benchmark (ceiling) on total primary current expenditure of the central government.
- An indicative benchmark (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.

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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.

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 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).

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

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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

(continued)

government or the CBT after 90 days from the due date or the expiration of the applicable grace period.

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 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.

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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.

[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.

Assumptions on Adjustment Factors of Quantitative Performance Criteria

(millions of U.S. dollars)

	2014				
	Year	Q1-Act	Q2-Act	Q3-Est	Q4-Est
Total External Financing	4134.5	1267.9	659.0	1458.3	749.2
Bilateral	200.0	200.0	0.0	0.0	0.0
Multilateral Financing	2429.0	974.2	544.8	586.2	323.8
AMF (Arab Monetary Fund)	76.0		76.0		
IMF (Budget Support)	1380.5	724.2	218.8	218.8	218.8
World Bank Group	750.0	250.0	250.0	250.0	
UE	222.5			117.4	105.0
Financial Market	1100.0	0.0	0.0	800.0	300.0
Market Financ. (possible US guarantee)	300.0				300.0
Market Financ. (possible Japan Guarantee)	300.0			300.0	
Sukuk	500.0			500.0	
Project Loans	346.9	72.6	105.5	57.7	111.1
Other (incl. Loan Transfers to SOEs)	58.6	21.2	8.8	14.4	14.3
Grants	137.9				137.9
Privatisation Receipts	0.0				
External debt service	954.4	208.2	294.5	198.6	253.2
Amortization	607.1	116	191	112	188
Interests	347.2	92	104	86	65
Residents Foreign Currency deposits at the BCT 1/					

Sources: Tunisian Authorities; and IMF staff estimates.

1/ as of end December 2013 estimated at USD 1,852.07 millions

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 type of expenditures),	*q*	*45*
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).	*m*	*30*
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).	*q*	*90*

Overall net external position of Tunisia (in conformity with our obligations under SDDS).	*q*	*90*
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*