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August 14, 2014

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

August 14, 2014

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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.

Letter of Intent

Tunis, August 14, 2014

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

Madame Managing Director,

1. The efforts of our government and the national dialogue process have led to the announcement of a clear calendar for the legislative and presidential elections that will complete the last phase of our political transition to democracy before the end of 2014. We are convinced that the announcement will help reduce investors' uncertainty and "wait-and-see" attitude, and strengthen the support of our development partners which will manifest itself in the "Invest in Tunisia" conference that will be held in the fall of 2014. With this renewed confidence, the Tunisian authorities remain firmly committed to implementing the economic program and reforms supported by the IMF.
2. Tunisia's economic situation is still fragile, with significant fiscal and external imbalances and a growth rate that is too low to reduce unemployment and meet the Tunisians' pressing expectations. In response to the situation, we conducted an extensive outreach campaign to make the public aware of the difficult financial constraints the country faces and the reforms and sacrifices needed to reduce vulnerabilities. To this end, we consolidated the consensus around our economic program by holding a national economic consultation among the representatives of the different political parties, trade unions, and civil society. We remain convinced that the implementation of prudent macroeconomic policies and structural reforms will preserve macroeconomic stability and promote higher and more inclusive growth.
3. The performance under the IMF-supported program was positive, with results in certain areas exceeding the targets despite the difficult national and international context during the transition period. Performance at end-March and end-June 2014 was in line with the projections from the last review. We accelerated the implementation of the programmed reforms and also made up for some delays accumulated during the political crisis that preceded the formation of the current government.

- *Quantitative performance criteria and indicative targets.* As initially projected, the quantitative criteria at end-March and end-June 2014 for net international reserves (NIR), net domestic assets (NDA) and the central government primary balance (on a cash basis) were met. We adhered to the continuous zero ceiling on accumulation of external arrears and the indicative target for the non-accumulation of domestic arrears. The quantitative indicative target for social spending and the ceiling on current spending at end-March and end-June 2014 were met.
- *Structural reforms.* Six of the seven structural benchmarks (SB) for end-June 2014 were met (Table 2a). In particular, a new haircut system was implemented for loans used by banks as collateral in refinancing operations at the Central Bank of Tunisia (CBT), the proposed new organic law of the CBT was presented to its Board of directors, a new banking resolution framework consistent with international practices was submitted to CBT management, the tax administration modernization plan was finalized, the consolidated balance of the 28 largest public enterprises was completed, and the household support program to accompany the reform of energy product subsidies was put in place (structural benchmark originally set for August 2013). The lender-of-last-resort facility (end-June benchmark that was not completed) was delayed to March 2015 to allow its alignment with the new banking resolution framework. In the interim, an “exceptional and temporary emergency liquidity” mechanism was adopted. The end-July benchmark (Table 2b) for the Banque de l’Habitat (BH) and Société Tunisienne de Banque (STB) restructuring plans will be adopted by the government in August 2014 (Prior Action for completing the fourth review) in accordance with international best practices. Regarding the audit of Banque Nationale Agricole (BNA) (end-July SB), delays on the part of the auditor pushed the completion date back to September 2014.

4. In view of the sound macroeconomic policies already implemented to achieve the main program objectives and the ongoing implementation of the structural reform program (Tables 1, 2a, and 2b), the government requests the completion of the fourth review of the program supported by the Stand-By Arrangement and the disbursement of SDR 143.250 million. The government would also like to modify the performance criteria for NIR, NDA, and the primary balance at end-September 2014 and propose new criteria for December 2014, as well as new indicative targets, as described in the attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU)

5. This Letter of Intent is based on the previous Letter of Intent (LOI) and MEFP approved on April 25, 2014. The attached MEFP outlines the key components of the government’s program and the measures planned by the Central Bank of Tunisia that we intend to implement during 2014. We remain determined to rigorously implement our program, though mindful of the difficulties in the domestic, regional, and international environment.

6. We are confident that the policies described in the attached MEFP are appropriate to the objectives of our economic program, which is designed to achieve short-term macroeconomic

stability while laying the necessary foundations for supporting growth and protecting vulnerable groups. We will remain vigilant, and we stand ready to take any additional measures that may be necessary to achieve 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.

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

Sincerely yours,

/s

Chedly Ayari
Governor of the Central Bank of Tunisia

/s

Hakim Ben Hammouda
Minister of Economy and Finance

Attachment I. Memorandum of Economic and Financial Policies

I. Recent Developments and Macroeconomic Outlook

Timid growth and contained inflation mark Tunisia's economic performance in a difficult national and international context. A downward revision of the economic growth estimate for 2013 from 2.6 percent to 2.3 percent—and solid performance of the chemical and mining sectors and a slight improvement in the agricultural sector—contributed to 2.2 percent growth (y-o-y) in Q1 2014. For 2014, the annual growth rate is projected at 2.8 percent, with a better agricultural season offsetting weaker-than-anticipated growth in the mechanical and electrical industries (IME) and the tourism sector. The announcement of a clear election calendar will help overcome investors' "wait and see" attitude, but the short-term risks remain substantial, particularly in the event of renewed security tensions, rising commodity prices, or a deterioration of key European partners' economic prospects. The increase in food prices and electricity tariffs drove inflation (on a year-on-year basis) up from 5 percent in March 2014 to 5.7 percent in June 2014, but core inflation remained contained, declining to 4.3 percent at end-June 2014. For the rest of the year, inflation will reach a high of 6 percent in September and then slow to 5.5 percent at end year, reflecting a slowdown of food product prices, actions aimed at controlling and monitoring distribution channels, and a tightening of monetary policy.

1. **The current account deficit continues to deteriorate.** The current account deficit widened to a record 8.4 percent of GDP in 2013, and downside risks remain high in 2014, with a current account deficit of 2.7 percent of GDP in the first quarter of 2014 and estimated at 2.3 percent of GDP in the second quarter. The widening deficit is attributable to increased energy imports due to a decline in national oil production and reduced volumes of gas transiting through the Algeria-Italy gas pipeline. Increased food imports following last year's weak agricultural production, weak exports of phosphates and energy byproducts, and tepid recovery of tourist revenue added further to the deficit. The implementation of tighter macroeconomic policies, a more flexible exchange rate, and the active promotion of our exports will help reverse this trend and reduce the current account deficit to 7.6 percent of GDP for 2014. On the other hand, gross reserves remain above the program target and represented \$7.1 billion (3.5 months of imports) at end-June 2014. During the past three months, and in line with the external imbalance observed, the value of the dinar (TD) vis-à-vis the euro and U.S. dollar has declined, with a 8.6 percent depreciation of the exchange rate during this period, eliminating the appreciation observed during the first two months of the year.

I. Performance Under the Program and Strategy

2. We are fully determined on the rigorous implementation of our economic program in order to preserve short-term macroeconomic stability and lay the foundation for more sustained and inclusive growth. The objectives of our program remain unchanged, and we focus during this review on the following areas:

- **Maintaining macroeconomic stability.** Mobilizing resources, controlling current expenditures, and tightening monetary policy, coupled with limited interventions in the foreign exchange market, are needed to maintain macroeconomic stability.
- **Laying the foundation for inclusive growth.** Defining the bank restructuring plans and reducing weaknesses in the banking sector, an improved budget structure supported by the implementation of tax reforms, more effective execution of public investment, and an ambitious program of structural reforms are needed to support the development of the private sector, the key engine of future growth.
- **Protecting vulnerable segments of the population** by strengthening social protection mechanisms and systematically assessing the social impact of the programmed reforms.

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

Fiscal policy

3. **Despite a difficult economic situation, we achieved by a wide margin the 2014 end-March and end-June fiscal objectives.** The primary deficit (cash basis) at end-March 2014 stood at 1.3 percent of GDP (compared to 2.1 percent of GDP projected under the program), primarily to the effect of revenue overperformance (0.5 percent of GDP) from taxes collected from oil companies (originally programmed for 2013 but received in 2014), higher VAT revenues, and dividends from non-oil public companies. At the same time, the wage bill at end-March exceeded the programmed level by 0.2 percent of GDP due to the impact of new hiring in late 2013 that was not originally planned; the wage bill will return to the programmed level during 2014 by containing the pace of recruitment and controlling promotions. The 2014 end-March and end-June targets for social spending were achieved, thanks to an increase in the number of beneficiaries covered by the “families-in-need” program and increased educational assistance. Available information on “below-the-line” financing confirms that the 2014 end-June target will be achieved by a wide margin.

4. **To reduce pressures on the balance of payments and address our financing constraints, a rigorous fiscal policy continues to be necessary while investment and development spending retain priority.** The underlying fiscal position—as measured by the structural fiscal deficit—excluding the effects associated with the economic cycle and exceptional transactions, such as bank recapitalization requirements or the repayment of arrears—was revised to 4.7 percent of GDP in 2014 (compared to a program projection of 4.9 percent of GDP). This

improvement of the fiscal position was achieved despite new constraints associated with transfers of 0.3 percent of GDP to the National Retirement and Social Security Fund (CNRPS), additional payments for security personnel (0.1 percent of GDP), additional spending for the elections (0.1 percent of GDP), and additional salaries originating from the sectoral agreements with the various trade unions, finalized in 2011, that had not yet been implemented (0.1 percent of GDP). The improved fiscal position was possible thanks to the savings target set in January 2014 in the execution of the 2014 budget, including savings in unallocated spending (0.5 percent of GDP) and salaries (0.2 percent of GDP). Additional improvements come from increased revenue mobilization achieved during the first semester of 2014, and the implementation of measures already incorporated in the 2014 budget or programmed in the revised budget law adopted in July 2014:

- **Reduction of energy subsidies.** We have gradually eliminated the energy subsidies provided to cement companies (through a cumulative 70 percent increase in electricity tariffs and a 94 percent increase in the price of gas over six months) for a budgetary gain of TD 180 million (0.2 percent of GDP). We also increased electricity rates for industrial and low-voltage consumers by 10 percent in both January and May 2014. The most vulnerable segments of the population were protected from the impact of this measure through the introduction of a second social (“lifeline”) tariff for customers consuming less than 100 kWh per month. The price of fuels (gasoline and diesel) also increased by about 6 percent on July 1, 2014, allowing us to generate the TD 100 million of savings envisaged in the 2014 budget law. Additional savings (0.1 percent of GDP) are expected through exchange rate valuation gains (from a greater-than-expected appreciation of the exchange rate in the first half of the year) and a reduction in energy subsidies extended to brick and glass producers. The energy subsidy reduction was accompanied by the implementation of social programs, a household support program, and an increase in the minimum salary (see section C).
- **Control of the wage bill.** We are committed to containing the wage bill to the level planned under the program. A salary and promotion freeze this year will offset the additional spending provided under the 2014 supplementary budget law. To reduce the wage bill, we froze new hiring—except for security forces and the education and health sectors—and hiring that was not completed in the year, but had been budgeted for, will not be carried over to next year’s budget. To better prepare the 2015 budget, the Council of Ministers will adopt a decree in August 2014 creating a civil service monitoring and steering committee, and will validate the recently finalized report on the structure of public sector salaries. This report will serve as the basis for a complete reform of the civil service that will include proposals introducing increased mobility between the public and private sector, thereby facilitating the rationalization of public officials’ salaries and control of the wage bill. Technical support will be requested from the World Bank/European Union to refine the evaluation and the recommendations of the report.
- **Revenue.** In view of our financing constraints, the additional revenue achieved in the first quarter of 2014 will be saved, bringing the total amount of revenue to 23.5 percent of GDP (0.4 percent of GDP above the programmed amount). This target will benefit from the measures identified during the third review and of new ones adopted in the LFC (Table 3) to further reduce

our financing requirements. These measures support the efforts we have made to revise the presumptive tax regime and combat tax evasion (see Section B).

5. **We also remain committed to taking additional measures to correct any deviation from the budgetary objective**, including reducing current spending (i.e., goods and services and subsidies), which was a source of budget overruns in the past. Investment expenditure and social spending (excluding subsidies) will be preserved, and will not be constrained by our fiscal consolidation strategy.

6. **The “new national borrowing campaign” and additional external budgetary support will serve to offset lower-than-anticipated external financing at the end of the year.** The national borrowing campaign—initiated in May 2014 with government securities of small denominations – resulted in large subscriptions by the public and banks and mobilized TD955 million. Greater donor support than expected— agreement on a U.S. guarantee allowing a \$500 million international market issuance (i.e., \$200 million more than initially programmed) and bilateral support from Algeria (\$250 million, of which \$150 million is in direct budgetary support)—will help offset lower sukuk issuance (the Islamic Development Bank is expected to guarantee \$120 million, i.e., \$380 million less than initially programmed).

Monetary policy

7. **The growth of monetary aggregates remains broadly in line with the program targets.** The money supply (M2) increased by 8.5 percent (year on year) during the first five months of 2014 due to weak mobilization of deposits. The criterion for net domestic assets at end-March and end-June 2014 was met by a wide margin, primarily due to a more than expected reduction of net credit to the government during the quarter. However, bank refinancing from the CBT increased and remains high at end-June (TD 4.8 billion excluding open market operations (OMO)—primarily reflecting seasonal cash withdrawals and a worsening current account deficit and its restrictive impact on banks’ liquidity.

8. **An immediate tightening of monetary policy is crucial to reduce future inflationary pressures.** Until now, controlled core inflation, a negative output gap (2 percent), and anemic credit to the private sector (7.6 percent year on year at end-May) justified the central bank’s current policy, which normalized the market rate at roughly 4.75 percent (25 basis points above the policy rate). However, the increase in the minimum salary, which impacts 900,000 Tunisians (including retirees), combined with the increase in electricity and fuel prices, a negative real interest rate, and the depreciation of the exchange rate observed in recent months indicate that Tunisia is facing increasing inflationary pressures. To this end, we have raised the CBT’ benchmark policy rate by 25 basis points (to 4.75 percent) on June 25, 2014 to contain inflationary pressure, and we are prepared to raise it further if pressures persist, including due to a larger external imbalance.

9. **We will continue our strategy of reforming the monetary policy framework.** The CBT continues to reduce the risk to the CBT’s balance sheet by increasing from 10 percent to 25 percent the haircut on the valuation of loans used as collateral, which will take effect in July 2014, and

increasing the share of government securities used as collateral from 20 percent to 40 percent (structural benchmark at end-December 2014). We plan to further strengthen the guarantee system by improving the current haircut system through the use of rating instruments. We have also begun a study on valuing government securities at market price instead of nominal value; the study will be completed by September 2014.

10. **The implementation of a lender-of-last-resort facility is needed to accompany the tightening of the eligibility criteria for CBT refinancing.** The lender-of-last-resort facility initially envisioned for end-June 2014 (structural benchmark) cannot be completed until March 2015 in view of the need to define further the eligibility criteria and liquidity standards, and to establish the new legal and institutional banking resolution framework. In the interim, a new “exceptional facility” was implemented on July 1, 2014; it will enable any solvent institution that is unable to provide top-tier collateral to access the facility by providing second-tier collateral, but at a penalty rate (200 basis points above the lending facility), while being subject to more intrusive banking supervision and to a precise restructuring plan—approved by the CBT—for improving the bank’s liquidity position.

11. **The monetary policy transmission channel will be strengthened and access to financing improved by modifying the excessive lending rate system.** Following the recommendations of the study on the impact of amending the law on excessive bank lending rates—conducted with World Bank assistance—the CBT Board has launched a broad consultation with the relevant ministerial departments to amend the law, if needed, by December 2014. This policy change will strengthen the monetary policy transmission channel and facilitate access to credit for small and medium-sized enterprises.

12. **The central banking law of the CBT is currently under revision.** A comprehensive set of new amendments will confer greater autonomy on the CBT (including institutional, operational, human resources, and financial autonomy), define its mission more clearly (by clarifying its objectives, mission, and instruments), and improve its governance, transparency, and accountability for. The revised draft law—which benefited from IMF technical assistance—was presented to the CBT board of directors in June 2014 (structural benchmark) and will be adopted by the government by September 2014.

Exchange rate policy

13. **The widening of the current account deficit increased pressures for a depreciation of the exchange rate.** The 8.6 percent depreciation of the dinar since March eliminated the appreciation seen at the beginning of the year, which had resulted from an improved political situation and the rigorous implementation of regulations governing holders of professional accounts in foreign currency. This initial appreciation occurred despite CBT interventions (currency sales), which were substantial (50 percent of the foreign currency supplied to the foreign exchange market in May and reduced to \$290 million in June 2014) and necessary to ensure that external payments for energy imports were properly and regularly executed. In view of the wider current

account deficit and need to preserve our official reserves, we will continue our policy of a more flexible exchange rate by:

- **Further limiting CBT interventions on the foreign exchange market.** We are committed to refraining from selling foreign currency to the exchange rate market, except for smoothing substantial exchange rate fluctuations that would result if large orders related to energy transactions were not satisfied. To preserve and strengthen our official reserves, we expect to intervene by buying foreign currencies on the market, particularly during periods when there is less demand associated with energy imports. These purchases will allow us to rebuild our reserves, reduce the overvaluation of the exchange rate (7 percent to 10 percent) and the banks' structural liquidity deficit.
- **Increasing swap transactions.** To increase the supply of foreign exchange in the market, we will revise the functioning of the swap market to allow banks to initiate swaps with the dinars and other currencies with the CBT.
- **Introducing weekly foreign currency auctions in December 2014** (structural benchmark). In this regard, the implementation of the electronic platform providing interconnection between banks and the entry into force of the market-maker-agreement provide us with real-time information on the quotations of the different participants in the exchange market. However, the introduction of the auction mechanism also requires the implementation of an efficient information system enabling the CBT to centralize flows of projected settlements in foreign currency and providing a clearer view of cash flows.

14. **Our development strategy will remain open and based on free trade.** We have adopted measures aimed at reducing the widening trade deficit through increased promotion of our exports and a rebalancing of our energy mix. As provided by World Trade Organization rules, we will not consider new restrictions or import surcharges except as a last resort, after exhausting market solutions that preserve adequate incentives, and only with very clear criteria, announced in advance, for removing them.

B. Laying the Foundation for Inclusive Growth

Financial sector policies

15. **The condition of the Tunisian banking system remains fragile.** Although the indicators at end-March 2014 shows an increase in banks' net profits (12 percent year on year), primarily attributable to financial fees and interest margins, the increased cost of deposits and weak demand for new credit could reduce further banks' profitability. Our gradual transition to international standards, including a more rigorous application of haircuts on loan collateral, contributed to a 14 percentage point increase in the provisioning rate, and a reduction of the capital adequacy ratio to 9 percent by end-December 2013, and pushed seven banks below minimum capital requirements required by regulations (six banks are below that threshold since end-March 2014). Asset quality continued to deteriorate slightly, with the ratio of nonperforming loans increasing from 14.9 percent

of total loans at end-2012 to 15.2 percent at end-December 2013 and 15.1 percent at end-March 2014 (or 20 percent, if we include loans transferred to bank-affiliated asset management companies).

16. **The banking strategy adopted by the Tunisian government calls for refocusing the government’s role on its principal mission, and rationalizing the number and influence of publicly held banks in the banking sector.** This strategic approach, which was presented to banks and civil society in April 2014, is based on the need to guarantee universal public banks’ financial soundness, establish a new governance framework, strengthen institutional capacities, and improve the legal framework. Based on this strategy, the plans for restructuring the banks—for which the audits were completed (STB, BH)— will be finalized and adopted by the government in August 2014 (Prior Action), in line with international best practices as described in Annex I. The audit of the Banque Nationale Agricole (BNA) could not begin until June 2014 because of the need to find a new auditor; the audit will only be completed by September 2014 (rather than July as anticipated in the program), with a restructuring plan based on international best practices finalized in November 2014 (new structural benchmark). For the time being, our action plan for the public banks is based on:

- **strengthened governance.** The implementation of the new decree allowed greater autonomy with respect to the role of the State, including in the recruitment and appointment of “competent” members for the board of directors. We plan to change the compensation system of banks’ board members in September 2014 and ensure that public banks are operating on a commercial basis and follow best management practices.
- **recapitalization of public banks.** This amount will come first from private shareholders, and public funding will be used only after the losses have been distributed among the existing shareholders (private and public). The public funds for the recapitalization of banks would be provided in the form of non-negotiable bonds (which would not be eligible for central bank refinancing). For the BNA, its capital will be at the level required by applicable regulations by end-2014. The plan for restructuring of the STB and BH will ensure that both banks will meet the minimum capital requirement of 10 percent in December 2014. These would imply total recapitalization costs of TD 1 billion (1.2 percent of GDP), which is the amount already budgetized.
- **creating an Asset Management Company (AMC).** Technical consultations on the proposed law—which was prepared with World Bank technical assistance—are at the final stage and we will submit the draft law in line with international best practices with the expectation to be adopted by the National Constituent Assembly in September 2014 (new structural benchmark), which will help ensure creation of the AMC in 2014. The new proposed law, which was initially conceived for the tourist sector, will provide for the creation of a universal AMC with clear eligibility criteria that will limit the contours of its mandate (e.g., amount of commitments, loans guaranteed by collateral). This law will be aligned with international best practices through: (i)

the adoption of clear, transparent governance rules accompanied by financial and operational autonomy; and (ii) the implementation of specific powers to accelerate the resolution and restructuring of nonperforming loans. In view of the importance of the tourist sector and its financial difficulties (its share of nonperforming loans has doubled since 2009, to about 54 percent of the total), we plan initially to limit AMC operations to tourist loans. The capitalization of the SGA—estimated at TD 150 million in the supplementary budget law—will adhere to the business plan prepared with support from the World Bank, and will be closely coordinated with the bank recapitalization program, in particular of public banks. We will not expand the AMC operations to other sectors until an in-depth study on the potential budget costs has been completed. Moreover, in December 2014, we will submit to the Constituent Assembly amendments to the law on asset recovery companies, which would enable them to be more effective in their actions.

17. **Banks compliance with prudential standards is essential.** In this regard, three of the seven banks that do not comply with the solvency ratio have submitted recapitalization plans that would bring their solvency ratio to the level required by end-December 2014. The other banks, which are all publicly owned, will comply with the regulations by end-December 2014 (new structural benchmark), in line with the restructuring plan. Also, we have imposed monetary sanctions on all banks that fail to comply with the current liquidity ratio pending the adoption of a new liquidity ratio (which will include off-balance-sheet operations) that was announced to the banks in March 2014 and will take effect in September 2014. The Directorate General of Bank Supervision (DGSB) will establish new procedures during 2014 to ensure that “fragile” banks are subject to tightened supervision and more frequent monitoring.

18. **The reform of banking supervision continues to be an absolute priority.** With technical assistance from the IMF, we have prepared in June 2014 a three-year plan (including prerequisites), adopted by CBT management, to establish a system of banking supervision that is based on an assessment of risks based on an individual and a consolidated basis. Our short-term priorities are to:

- **Strengthening DGSB human resources.** We are aware that the success of our action plan will depend on the human and financial resources provided to the DGSB. Accordingly, we hired 12 individuals in 2013, representing about one-fourth of the envelope expected for 2012–14, and we plan to double this figure in 2014 and change the BCT hiring criteria to allow the hiring of experienced, qualified personnel (new structural benchmark), above all to strengthen on-site inspection. The DGSB’s effectiveness will be further strengthened by formalizing its powers and responsibilities as soon as possible and by instituting clear rules on relations between the different organizational units within the DGSB by March 2015.
- **Improving reporting.** By June 2014, the CBT, with the support of IMF technical assistance, will finalize the Uniform Bank Performance Reporting (UBPR) benchmarking indicator—used jointly by the DGSB and the Directorate General of Financial Stability and Risk Prevention (DGSFPR)—which will be available 60 days after the end of each quarter and provide a simplified risk rating system by December 2014. In addition to this mechanism, the new system of accounting,

financial, and institutional data of banks will be put in place—with IMF TA assistance—in December 2014 (structural benchmark) and automated in June 2015.

- **Strengthening inspections and integrating on-site inspections into the banking supervision process.** Our inspection plan provided for 14 inspections this year (compared to five in the previous year), and we plan to implement formal procedures by December 2014 which will define the criteria for the inspection plan and structure of teams. The coordination between the different units of the DGSB—particularly between on-site and off-site inspection—and with other areas of the CBT (e.g., DGSFPR) will also be strengthened.
- **Strengthening the internal control of banks.** Following articles 52 and 53 of Circular 2006–19 on internal control, the DGSB asked credit institutions to provide it with reports on internal control and risk management, in accordance with applicable regulations. Based on the reports submitted for 2013, the DGSB will conduct a diagnostic assessment of the credit institutions' rating systems and ask institutions with weak systems to submit action plans by end-September 2014.

19. **A banking crisis and resolution management mechanism in line with international best practices is being finalized.** A draft banking law was prepared with technical assistance from the World Bank and IMF to strengthen bank supervision and regulation in Tunisia and establish a sound legal framework for the resolution of insolvent banks. The proposed law was submitted and presented to the CBT management in June 2014 (structural benchmark) and will be adopted by the government in September 2014. The proposed amendments to the draft central bank law, including the establishment of a lender of last resort facility, will strengthen the banking resolution framework. In addition, the provisions on an operational structure and legal framework appropriate to the establishment of a deposit guarantee fund are being drafted with technical assistance from the World Bank.

Fiscal reform

20. **The structure of public expenditure must be improved to support medium-term growth and rebuild fiscal buffers.** In addition, our medium-term fiscal consolidation strategy will be accompanied by fiscal reforms—tax policy, tax administration, public expenditure management, reform of public enterprises, effectiveness of public investment—which remain essential to support growth.

21. **The equity, efficiency, and transparency of the tax system—and the mobilization of revenues—continue to be the key pillars of our tax policy.** All the existing tax laws and codes will be consolidated into a single tax code in September 2014 (structural benchmark) so as to increase the transparency of the tax system. Following consultations held in 2013 and discussions in the 2014 national economic dialogue, the government's tax policy strategy will be presented at the National Tax Consultations to be held in September 2014; an action plan will be adopted by the Council of Ministers in October 2014 (new structural benchmark). In the context of a comprehensive tax reform, we plan to continue revising the corporate tax (CIT) to achieve gradual convergence of the off-shore

and on-shore sectors over the coming years, and announce it according to a clear timetable and in line with improvements in tax administration (the difference between the tax rates in these two sectors was reduced by half in the 2014 budget). For the time being, and for the 2015 budget law, our actions will focus—with IMF technical assistance—on reforming the VAT and excise tax and simplifying the existing presumptive tax system.

22. **The reform of the tax administration will be governed by the implementation of the new modernization plan.** This plan, which was adopted by the Ministry of Economy and Finance on August 7, 2014 (structural benchmark of end-June), aims to establish a unified tax administration and strengthen audit and evaluation mechanisms. The implementation of the plan will be aided by the creation of a new unit responsible for modernization within the General Directorate of Taxes (DGI), and supported by IMF technical assistance. The strengthening and restructuring of the Large Taxpayers Unit (LTU) is ongoing, with the integration of all tax units and the adoption of a selective approach to tax audits (preparation of targeted criteria and objectives). The tax audit function will be strengthened by lifting bank secrecy provisions that currently hinder the tax administration's communication rights and the collection and use of information for tax audit purposes (including for the presumptive tax system), while protecting taxpayers' rights and recouping information collected from the health insurance and social security system. We are determined to combat tax evasion through new regulations requiring that large transaction amounts be paid by check, introducing a tax certificate for transactions with the government (provision of goods and services), and strengthening the risk management unit within the customs administration.

23. **The monitoring of public enterprise performance was improved.** The final report prepared by the Public Enterprise Monitoring Committee on the financial position of 28 public enterprises—representing 80 percent of the public sector's turnover—indicates a substantial financial deterioration of the sector between 2010 and 2012, with a deficit of 1.2 percent of GDP (including 24 enterprises in a deficit position). In response to this evaluation, rehabilitation measures have been identified for the most vulnerable public enterprises (i.e., Tunisair) and are being examined on a case by case basis, depending on needs. In addition, we are developing elements of a new regulatory framework for the governance of public enterprises, which would provide greater independence and responsibilities to their boards of directors and management. For the enterprises receiving subsidies for energy and food products, the government is committed to regularly provide budget appropriations and conduct ex-post verification once financial accounts are closed. Following the recommendations of the audit report for the energy companies presented to the Council of Ministers in August 2014, the priorities for the energy companies will focus on improving recovery and management of expenditures and, in the context of the 2015 budget, eliminating cross-subsidies for the Société Tunisienne de l'Électricité et du Gaz (STEG) and the Société Tunisienne des Industries de Raffinage (STIR), which will import their energy requirements directly instead of going through the refinery company Entreprise Tunisienne d'Activités Pétrolière (ETAP).

24. **Efforts to improve public expenditure management continue.** All payment orders authorized during the carryover period for 2013 were paid, and the budget execution statements we plan to prepare—with IMF technical assistance—will facilitate more regular reconciliation of

authorized, budgeted, and disbursed expenditures. The draft of the new functional budget classification was completed in September 2014, facilitating greater transparency and comprehensiveness in the budget preparation. We also plan to review the completeness and quality of budget documentation and are requesting technical assistance from the IMF staff for a report on financial and fiscal risks. Our immediate efforts led to the creation of a National Public Accounting Standards Board to introduce double-entry bookkeeping and focus on the new budget nomenclature (programmatic, budgetary, and accounting). Also, the draft organic law, prepared with technical assistance from the European Union and France, will be presented to the Council of Ministers in September 2014, and will lead to greater flexibility in managing appropriations (including in the control a priori) and greater accountability of managers.

25. Improved execution and effectiveness of public investments is needed to generate inclusive growth. Public investment continues at the rate observed during the past two years with a budget execution rate of 7 percent during the first quarter of 2014. The new procurement rules, which are consistent with the recommendations of the World Bank technical assistance program, took effect on June 1, 2014 and will considerably simplify and modernize procedures and accelerate public investments in the regions. We remain convinced that the professionalization and decentralized management of public projects in the regions and the implementation of procedures to remedy land deeds issues in the project preparation phase will help speed the execution of public investments. In that context, following the visit of 24 governorates, the regional project monitoring committee will present its recommendations on the main constraints to the implementation of regional investment projects to the government in July 2014.

Structural reforms

26. Our structural reform program will continue to focus on improving the business climate and promoting a competitive private sector that can generate inclusive growth. To this end, we will step up our efforts, inter alia, to simplify and clarify regulations for investments, promote competition, and facilitate trade.

27. The investment code, prepared with technical assistance from the World Bank following consultations with civil society and donors, was withdrawn from the Constituent Assembly for revision and its further simplification. The government considered the new code—which was intended to encourage private investment through a more transparent and efficient regulatory framework and the rationalization of incentives—as too complex and as leaving too much discretion to the implementation decrees. Nonetheless we remain convinced that a new, simplified investment code is needed. Accordingly, we plan to introduce a list of measures in September 2014—intended to supplement the current code—to reduce restrictions on investments. These measures—approved by the Council of Ministers—will be added to the current code in December 2014.

28. The passage of “economic” laws—deferred due to the ANC’s busy schedule, which focused on the electoral calendar—is a priority for our government. We are committed to

taking the necessary measures to advance the legislative calendar to pass the following laws in particular:

- **The collective proceedings law (Law 95).** In parallel with the reform of the banking law, we have embarked on a process to pass a new law on collective proceedings (commercial bankruptcy proceedings) —prepared with World Bank assistance. The law will modernize and simplify the process of restructuring companies and liquidating insolvent companies. We are committed to ensuring that the new law sets out clear rules regarding the government’s status as preferred creditor and to grant rights to private creditors to vote on reorganization plans.
- **The competition law.** The proposed law—submitted to the Constituent Assembly in 2013—will be reviewed by the Assembly during the summer of 2014. The final version of the competition law is intended to reduce the government’s intervention in the economy, reduce excessive regulation, and increase competition between companies.
- **The Public-Private Partnership Law.** The proposed law—which will facilitate private concessions—is now being reviewed by the parliamentary committees and will be adopted as early as possible in 2014.

29. **In parallel with the amendment of the relevant laws, we are continuing to simplify administrative procedures.** To this end, we have rationalized a number of administrative procedures that burdened the private sector in the areas of transport, customs, and exports. We remain committed to continue on this path based on the expected outcomes of the regulatory “guillotine” project.

30. **The integration of Tunisia’s economy in the global economy is essential to generating more inclusive growth.** We remain committed to promoting trade, including the reduction of tariff and nontariff barriers and enhancement of commercial agreements with neighboring and African countries. Discussions were initiated with the European Union in 2012 in the context of negotiating a comprehensive free trade agreement (DFTCA). To further improve the integration of Tunisia’s economy into the global economy, the action plan developed as part of the export development program (supported by the World Bank PDE III program) will allow, inter alia, to improve the logistics at the Radès port (Tunisia’s main port) and build a new deep-water port at Enfindha.

31. **We are committed to reducing obstacles to a proper functioning of the labor market.** The technical committees (work and professional relations, social protection, employment, regional development, and investment) established to implement the social contract signed on January 14, 2013 with employers and trade unions, have begun their work, which will be presented during the national economic dialogue. A broad consultation will be held to discuss the new employment strategy, which is expected to culminate in labor market reforms, including an evaluation of “flexi-security” in labor relations, and to reduce the structural asymmetry of skills prevailing on the market. In regard to programs to promote jobs, the support programs for small and medium-sized enterprises financed by the World Bank and the micro-project programs financed by the Banque Tunisienne de Solidarité and the Fonds National de l’Emploi will create jobs for

young Tunisians. We have also started developing a professional training program for unemployed university graduates, and an initiative that provides incentives for firm creation in disadvantaged regions.

32. **Reliable statistical information is critical to monitoring and evaluating macroeconomic policies and implementing social programs.** In this context, we are undertaking a comprehensive diagnostic assessment of our statistics system in cooperation with Eurostat, and we plan—with the support of IMF technical assistance—to strengthen our institutional mechanism and the system used to produce the national accounts (particularly the quarterly demand side), monetary statistics and the balance of payments. This will enable us to expand the regular publication of the results of surveys on current economic, employment, and household living conditions. In parallel, we started working on a legal framework to ensure and protect the independence of the National Statistics Institute (INS).

C. Protecting the Most Vulnerable

34. **Protecting the most vulnerable is our absolute priority in implementing fiscal and structural reforms.** In addition to the measures already included in the 2014 budget law (a social housing program, increase in the income tax deduction for the poorest households, and the introduction of an additional lifeline electricity rate), the agreement with trade unions will increase the guaranteed minimum salary (SMIG and SMAG) by about 6 percent, effective retroactively from May 1, 2014. This increase will benefit 900,000 individuals (primarily private sector workers, including roughly 600,000 retirees). In order to further improve our targeting system for social benefits, we completed an evaluation of school assistance programs which showed a 25 percent “leakage” to non-poor; we will present the conclusions of the evaluation of the needy families/health benefits card program in September 2014. We accelerated the pace of work on the unique social identifier, which is now available to 7.5 million Tunisians and will be used to create a new “targeting system” that will be refined over the coming months as “exclusion and inclusion errors” are corrected. In the meantime, in view of the imminent fuel price increase and Ramadan, we put in place the following household support program (end-June structural benchmark):

- expansion of the existing program of assistance to families in need (PNAFN) from 220,000 in 2013 to 250,000 beneficiaries in 2014; the system currently benefits 235,000 individuals;
- increase of TD 10 for all beneficiaries of the PNAFN (representing a 10 percent increase) to an amount of TD 120 month/family. Families having children at schooling age will receive an additional TD 10 per month per child (up to three children per family);
- provision of one-time, temporary assistance of TD 80 (TD 40 in June and TD 40 in July) for the 235,000 PNAFN beneficiary households and for an additional 50,000 poor households identified by the regional committees; and

35. **The deficit of the pension system calls for urgent action. The national retirement and social security fund (CNRPS) shows an annual deficit of TD 450 million (about 0.5 percent of**

GDP) in 2014 and currently has no cash reserves. To address this deficit, the government decided to provide a TD 250 million transfer in the 2014 revised budget law 2014. In the context of the social pact, we will review long-term scenarios for reform of the retirement and health insurance system in order to ensure the system's long-term sustainability. These studies will be supported by a support program and technical assistance financed through the transition fund.

Annex. Principles for Successful Restructuring of Public Banks

The best experiences with restructuring plans include **a clear, specific timetable and the following pillars:**

Financial restructuring

The purpose of financial restructuring is to restore solvency (net assets) by rehabilitating and strengthening banks' balance sheets.

- Existing and new fit-and-proper private shareholders should be asked to contribute to recapitalization through cash injection. Existing shareholders will bring the bank to solvency if needed, and public funds can be used to bring the bank back to minimum capital requirements once sources of private capital have been exhausted.
- Before any public funds are injected, the shares of existing shareholders have to be diluted or the overall loss has to be distributed amongst them.
- The government should seek authorization in a supplementary budget if the government's share of the recapitalization costs is higher than the budgeted amount.

Operational restructuring

Operational restructuring aims at creating the conditions for restoring banks' sustained solvency and profitability.

- To ensure good corporate governance, Bank Board members representing the State and bank managers are fit and proper and professionally suitable; and a relationship framework should be signed to govern the interaction between the Finance Ministry and each state-owned bank. The latter will help ensure no political interference in banks' commercial operations.
- To ensure effective governance and communication in the use of public funds for bank recapitalization and restructuring, the following requirements will need to be set:
 - a. A high-level committee comprising the Minister of Finance and the CBT Governor should be established to coordinate the process, including approval of the overall strategy and monitoring of progress;
 - b. The committee should appoint a spokesperson to be in charge of the communication strategy of the recapitalization and restructuring process, to ensure timely and consistent information to the public;
 - c. The State's interest in the banks should be managed in a dedicated, specialized unit set up at the Ministry of Finance.

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

	Cumulative Flows Since the Beginning of 2014												
	Mar 2014				Jun 2014				Sep 2014		Dec 2014		Mar 2015
	Prog. 01/24/14	PC w/ Adjusters	Actual	PC Status	Prog. 04/25/14	Est. PC w/ Adjusters	Est./Act.	PC Status	Prog. 04/25/14	Revised PC	Prog. 04/25/14	New PC	IT
Quantitative Performance Criteria	(Millions of Tunisian Dinars)												
1. Floor on the primary balance of the central government (cash basis excl. grants)	-2,796		-1,104	Met	-2,806		-2,155	Met/TBC	-4,007	-3,793	-5,609	-5,587	-1,233
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock)	3,952	4,327	2,457	Met	4,086	4,840	2,995	Met/TBC	4,071	3,961	1,173	1,466	2,549
	(Millions of US\$)												
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock)	5,308	5,067	5,180	Met	4,754	4,268	4,342	Met/TBC	5,275	5,487	7,066	6,877	6,579
Continuous Performance Criteria	(Millions of Tunisian Dinars)												
4. Ceiling on the accumulation of new external debt payment arrears by the central government	0		0	Met	0		0	Met	0	0	0	0	0
Quantitative Indicative Targets	(Millions of Tunisian Dinars)												
5. Ceiling on Current Primary Expenditure	4,253		4,058	Met	8,267		8,085	Met/TBC	12,796	12,915	17,815	18,033	4,638
6. Floor on Social Spending 3/	229		282	Met	562		624	Met	900	962	1,350	1,412	310
7. Ceiling on the accumulation of new domestic arrears	0		0	Met	0		0	Met	0	0	0	0	0
Program assumptions on which adjusters are calculated in case of deviations													
External Financing of the central government on a cumulative basis (in US\$ million) 4/ <i>of which:</i> Multilateral (excluding IMF), bilateral and budget grants	544		230		707		352		1,163	1438	2,771	2647	
Public debt service (interest and amortization) on a cumulative basis (in US\$ million)	213		203		506		459		708	662	958	913	
Bank recapitalization (in million TD)	0		0		0		0		0	300	0	700	
Privatization receipts (in million USD)	0		0		0		0		0	0	0	0	
Resident deposits at the BCT (in million USD) 5/	1,854		1,852		1,852		1,607		1,607	1,607	1,607	1,607	
Program exchange rate TD/ U.S. dollars					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/ Disbursement, includes project loans and capital market access but excludes IMF budget support.

5/ At program exchange rate.

Table 2a. Tunisia: Structural Benchmarks for the Period January–June 2014

	Objective	Date	New Date	Comments
Structural benchmarks				
I. Financial sector				
Submission to the management of the Central Bank of Tunisia of a banking resolution framework in line with international practices	<i>Crisis management and financial sector stability</i>	Jun-14		MET. A new banking law was prepared with technical assistance from the IMF and World Bank and submitted to CBT management.
Submission to the CBT board of the draft of the new central banking law in line with best international practices	<i>Financial sector stability</i>	Jun-14		MET. A new central banking law in line with international practices was prepared with technical assistance from the IMF and presented to the CBT board on June 25, 2014
II. Fiscal policy				
Adoption by the Ministry of Finance of a plan to modernize tax administration	<i>Expand tax base</i>	Mar-14	Jun-14	MET with delay. A plan to modernize tax administration was completed with technical assistance from the IMF and adopted by the Ministry of Finance in August 2014.
Unification of all public accounts into a Single Treasury Account (excluding accounts for project loans) at the CBT	<i>Better monitoring of the fiscal management</i>	Mar-14		MET. All accounts of the government (excluding accounts for project loans) were consolidated in a Single Treasury Account.
Finalize the audit of the electricity company (STEG) and of the petroleum refinery company (STIR)	<i>Lower fiscal risks</i>	Mar-14		MET. The first report on the two companies' operations 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 the generalized energy subsidies	<i>Protecting the most vulnerable</i>	Mar-14	Jun-14	MET. A household support program was put in place July 2014 ahead of the fuel price increase.
Prepare a consolidated balance sheet for the 20 main public enterprises (2010-12).	<i>Better assessment of risks</i>	Jun-14		MET. A report with the balance sheet for the 28 largest firms was prepared.
III. Monetary and exchange rate policies				
Implementation of an electronic bank interlinking platform and launch the Market Makers Agreement	<i>Greater exchange rate flexibility and increase of the banking liquidity on foreign exchange</i>	mid-Mars 2014		MET. The electronic platform is online and the market maker agreement is effective.
Presentation to the Central Bank board of the impact study for removing the upper limit of excessive rates for enterprises and to modify it for consumers	<i>Financial sector stability and better transmission of monetary mechanisms</i>	Mar-14		MET. The impact study, conducted with support from the World Bank, was presented to the CBT board March 26, 2014.
Implement an increase of the haircut for loans used as collateral for refinancing operations to at least 25%.	<i>Enhancement of the monetary transmission mechanism</i>	Mar-14	Jun-14	MET. A new regulation was put in place March 28, 2014 and communicated to the banks. The haircut system is effective since July 1, 2014
Establishment of the lender of last resort facility	<i>Financial system stability and better crisis management</i>	Jun-14	Mar-15	NOT MET. An interim, "exceptional" system was adopted June 25, 2014. The lender of last resort facility – in line with the bank resolution framework – will be put in place in March 2015.

Table 2b. Tunisia: Prior Actions and Structural Benchmarks for the Period July–December 2014

	Objective	Date	New Date	Comments
Prior Action				
Adoption by the government of the restructuring plans for BH and STB in line with international best practices as described in Annex I	<i>Financial sector stability</i>			
Structural Benchmarks				
I. Financial sector				
Completion of the financial audit of the Banque Nationale Agricole (BNA)	<i>Financial sector stability</i>	<i>Jul-14</i>	<i>sept.-14</i>	In progress. The selection of a new auditor delayed the completion of the BNA audit to end-September 2014.
Creation of Asset Management Company (AMC) through the publication in the Official Journal of the Law on the AMC	<i>Financial sector stability</i>	<i>Sep-14</i>		
Adoption by the Government of the BNA restructuring plan	<i>Financial sector stability</i>	<i>Nov-14</i>		
Double the number of DGSB supervisors hired in 2013 and revise the CBT hiring criteria to facilitate the hiring of qualified personnel	<i>Financial sector stability</i>	<i>Nov-14</i>		
All banks, including public banks, to comply with minimum solvency ratio required by the existing regulations (10 percent)	<i>Financial sector stability</i>	<i>Dec.-14</i>		
Development and implementation of the new reporting and rating system for banks	<i>Financial sector stability</i>	<i>Dec-14</i>		In progress. Work on the new rating and reporting system is in progress with technical assistance from the IMF.
II. Fiscal policy				
Government approval of the new tax code	Enhance transparency of the tax system	<i>Sep-14</i>		In progress. All new rules will be included into the new code.
Following national consultations on taxation, adoption of a tax reform plan covering direct and indirect taxes by the Council of Ministers.	Expand the tax base and improve equity	<i>Oct.-2014</i>		
III. Monetary and exchange policies				
Ensure that the proportion of the refinancing volume at the CBT backed by government securities is at least 40 percent for each bank	<i>Enhancement of the monetary transmission mechanism</i>	<i>Dec-14</i>		Completed. Circular issued in March 2014 and will take effect on January 1, 2015
Implementation of the weekly foreign exchange auction mechanism	<i>Greater exchange rate flexibility</i>	<i>Dec-14</i>		
IV. Structural reforms/private sector development				
Decrees for implementing the new investment code, in line with the objective of protecting market access, reducing restrictions to investments and rationalizing incentives	<i>Support for balanced growth driven by the private sector</i>	<i>Sep-14</i>		The decrees will not be submitted to Parliament because the government decided to withdraw the draft law on the investment code from parliament; New measures for investment promotion will be taken. They will eventually be included in the new code.

Table 3. Tunisia: Compensatory Fiscal Measures, March/June 2014

	Mar-14		Jun-14	
	In Millions of TD	In Percent of GDP	In Millions of TD	In Percent of GDP
Revenue	260	0.31	130	0.16
Tax policy	100	0.12	130	0.16
Alcoholic beverages: 8 percent increase excises taxes	20	0.02		
Cigarettes: 10 percent increase excise taxes	50	0.06		
Vehicle taxes 1/	30	0.04	15	0.02
Tourism taxes			75	0.09
Stamp taxes			30	0.04
Other tax measures incl. exceptional taxation on revenues			10	0.01
Tax administration	160	0.19		
Tunisie Telecom: enhanced tax control	110	0.13		
Expedite judiciary procedures	50	0.06		
Current expenditure	40	0.05		
Decreased energy subsidies 2/	40	0.05	7	0.01
Total	300	0.36	130	0.16

1/ In March: at the moment of resale for cars imported by tunisians leaving abroad.

2/ in March: 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 August [xx], 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 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.

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 \$1,852.07 million at the program exchange rate.

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 \$7.937 billion, with the stock of reserve assets equal to \$8.645 billion and the stock of CBT liabilities in foreign currency equal to \$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.

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.

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.

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.

J. Adjustment Factors for the Program Performance Criteria

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	739.2	343.8	1532.1	1431.0	4046.1
Project loans	21.8	99.8	88.4	101.8	311.8
Multilateral donors	509.3	221.7	829.0	895.1	2455.0
AMF (Arab Monetary Fund)	0.0	0.0	0.0	43.5	43.5
IMF (budget support)	509.3	221.7	446.1	221.7	1398.7
World Bank Group	0.0	0.0	250.0	500.0	750.0
European Union	0.0	0.0	132.9	129.9	262.8
Bilateral donors	200.0	0.0	100.0	0.0	300.0
Algeria Budget support	0.0	0.0	100.0	0.0	100.0
Turkish loan	200.0	0.0	0.0	0.0	200.0
Financial Market Access	8.1	22.4	514.7	434.1	979.3
Sukuk	0.0	0.0	0.0	120.0	120.0
Market Financ. (with possible Japanese guarantee)	0.0	0.0	0.0	300.0	300.0
Market Financ. (with possible US Treasury guarantee)	0.0	0.0	500.0	0.0	500.0
Other (incl. Loan Transfers to SOEs)	8.1	22.4	14.7	14.1	59.3
Budget Grant	0.7	40.7	87.5	49.0	177.9
Privatization Receipts	0.0	0.0	0.0	0.0	0.0
Government External Debt Service	207.7	303.9	202.8	250.6	965.0
Amortization	119.9	197.0	114.4	186.2	617.6
Interest	87.9	106.8	88.3	64.4	347.4
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

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.

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 observed at end December 2013. 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 above.

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

<i>Type of Data and Description</i>	<i>Periodicity Weekly (w) Monthly (m) Quarterly (q)</i>	<i>Delay in Days</i>
GDP: Supply and demand at current, constant, and the previous year's prices, including sectoral indices.	<i>q</i>	45
Inflation: Including the underlying inflation of non-administered and administered prices.	<i>m</i>	14
Fiscal Sector		
Tax and nontax revenue of the central government decomposed on the basis of main tax and nontax revenues items	<i>m</i>	30
Total expenditures: current and capital, transfers and subsidies.	<i>m</i>	30
Capital expenditure: by type of financing: domestic and external (differentiating loans and grants), and by main sectors and projects (agriculture, social, infrastructure).	<i>m</i>	45
Current expenditure: by type of expenditure: wages, goods and services, transfers.	<i>m</i>	45
Social expenditure	<i>q</i>	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).	<i>q</i>	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),	<i>q</i>	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.	<i>m</i>	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.	<i>m</i>	60
External payment arrears: external debt contracted and guaranteed by the government.	<i>q</i>	30
Debt rescheduling: possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	<i>q</i>	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).	<i>m</i>	30

External Sector		
Imports of Petroleum Products: average import price of main petroleum products.	<i>m</i>	30
Foreign trade: imports and exports of goods, including volumes and prices, by sector.	<i>m</i>	30
Deposits: Stock of foreign currency deposits, according to the residence of the holder.	<i>m</i>	14
External debt:	<i>q</i>	30
Debt service (amortization and interest) of institutional agents by instrument and at type of currency (in foreign currency and its equivalent in dinars).	<i>m</i>	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).	<i>q</i>	90
Overall net external position of Tunisia (preliminary).	<i>q</i>	90
Overall gross external debt position	<i>q</i>	90
Overall net external position of Tunisia (in conformity with our obligations under SDDS).	<i>A</i>	180
Balance of payments: Prepared by the CBT	<i>q</i>	30
Monetary and Financial Sector		
CBT accounts at the current exchange rate: detailed table including the monetary system.	<i>m</i>	30
CBT accounts at the program exchange rate: Including net international reserves.	<i>m</i>	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 (TD/FX or FX/TD), 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	<i>m</i>	30

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.		
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.	<i>m</i>	30
Direct refinancing of commercial banks by the CBT: Breakdown by bank.	<i>m</i>	14
Interest rates: Deposit rates, interbank rates, and lending rates.	<i>w</i>	14
NPLs: Stock of banking sector NPLs, and breakdown by commercial banks.	<i>q</i>	60
Balance sheets of commercial banks, including detailed income statements, in accordance with "Uniform Bank Performance Reporting" agreed with Fund staff.	<i>q</i>	60
<i>Other Information to be Reported</i>		
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.	<i>d</i>	3