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

May 2, 2016

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, May 2, 2016

Madam Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, NW
Washington, DC 20431
USA

Madam Managing Director:

Since January 14, 2011, Tunisia's path has been remarkable in many ways. The election of a constituent assembly in October 2011, whose work culminated in the approval of a new constitution in January 2014, opened the way towards a new democratic era. The legislative and presidential elections held in October 2014 and the naming of a government supported by a large parliamentary majority have been milestones marking this political transition. Finally, the fact that the 2015 Nobel Peace Prize was awarded to the Tunisian National Dialogue Quartet highlighted and recognized the efforts made by all parties in building a pluralistic democracy in Tunisia. This path is all the more remarkable in that it has been accompanied by several exogenous shocks, in particular continued weak growth in the euro zone (our main trading partner), the deteriorating security situation in Libya, worsening social tensions, and the repercussions of the recent cowardly and barbaric terrorist attacks.

The IMF stand-by arrangement approved in June 2013, which has just ended, provided major financial support for carrying out economic reforms to maintain macroeconomic stability, in spite of a difficult regional and global environment, and so that the necessary policies could be put in place as a foundation for further growth. Thus, work has continued in pursuing fiscal consolidation and keeping the inflation rate under control, foreign-exchange reserves have been stabilized, and risks to financial stability have been lessened in the wake of the restructuring of public banks. However, several sources of vulnerability remain: unemployment remains stubbornly high, external imbalances persist, the wage bill weighs heavily on government expenditure, banking sector vulnerability continues, and the business climate is not sufficiently attractive to bring in the investment flows needed to create more jobs.

Meeting the challenges that Tunisia faces will require a transformation of the current development model, in order to reduce the vulnerabilities in our economy and meet the Tunisian people's aspirations to achieve stronger, more inclusive growth. Accordingly, the government has developed an economic vision, coupled with a national program of major reforms to enable Tunisia's growth potential to flourish in the next five years. This vision will be spelled out in detail in the 2016–20 five-year plan which will be submitted to the Assembly of the People's Representatives (ARP) in June 2016; it will serve as the foundation for the economic and reform program that we are committed to carrying out, and we will present it at an international conference to be held in the coming months.

We are requesting support from the International Monetary Fund through an Extended Fund Facility for a four-year program in the amount of SDR 2.045625 billion (375 percent of quota, or about US$2.8 billion). The main objective of the new arrangement is to restore Tunisia's economic growth in order to create more jobs and reduce unemployment. The new arrangement will also help Tunisia pursue prudent macroeconomic policies, further reduce the economy's vulnerability to exogenous shocks, and foster more inclusive development in keeping with the aspirations of the Tunisian people. We also hope to build buffers to respond in the event of exogenous shocks, especially in view of the fragile regional security environment. The program will demonstrate our determination to pursue adequate policies and will serve as a catalyst to attract investment and financial support from other development partners.

The memorandum on economic and financial policies (MEFP), hereto annexed, sets out the principal elements of the program of reforms and policies that the government and the central bank intend to carry out during the period 2016 to 2019. It also describes macroeconomic objectives, structural reforms, and indicators that pertain to the first year of the program. We are determined to devote our fullest efforts to implementing our program, while remaining aware of the difficulties associated with the national, regional, and international contexts.

The progress we make in carrying out our program will be monitored through semi-annual reviews based on prior actions, quantitative criteria, and structural benchmarks as described in the accompanying MEFP and the technical memorandum of understanding (TMU). There will be eight such reviews to examine the progress made in carrying out the program and to agree on any corrective measures necessary to achieve program objectives. The first two reviews of Tunisia's performance under the Extended Fund Facility must be completed no later than December 31, 2016, and June 30, 2017, respectively.

We are convinced that the policies described in the accompanying MEFP are adequate for achieving the objectives of our economic program. We will remain vigilant and stand ready to take any further measures that might prove necessary to achieve those objectives. We will consult with IMF staff on the adoption of such measures, and prior to any revision of the macroeconomic policies described in the MEFP, in accordance with the IMF's policies on such consultations. All information and data required for program monitoring will be reported to IMF staff.

In accordance with the usual provisions of an arrangement of this kind, we have assessed the central bank's safeguards. In this connection, we have also put in place a technical memorandum of understanding between the Central Bank of Tunisia and the Ministry of Finance to clarify responsibilities associated with financial obligations with respect to IMF resources which, in the case of budget support, will be held by the Central Bank of Tunisia pending their utilization.

We authorize IMF staff to publish this letter of intent together with its attachments (MEFP, Tables 1 and 2) and the accompanying IMF staff report.

Sincerely yours,

/s/	/s/
Chedly Ayari	Slim Chaker
Governor of the Central Bank of Tunisia	Minister of Finance

Attachment I. Memorandum on Economic and Financial Policies

The Tunisian government has drawn up an economic program that aims at generating stronger and more inclusive growth to support job creation. This program is supported by an action plan on major reforms that will be part the forthcoming five-Year Development Plan 2016-20. This memorandum describes the macro-critical elements of the IMF-supported government program over a four-year period under an Extended Fund Facility (EFF) arrangement.

I. ECONOMIC CONTEXT

2. **Tunisia's economy has shown great resilience in withstanding internal and external shocks.** Although weak, growth remained positive in 2015 at 0.8 percent, mainly due to exceptionally high olive-oil production and the decline in global energy prices. However, difficulties in Tunisia's regions, uncertainty related the last phase of the political transition, ongoing social tensions, and above all, deadly terrorist attacks have weighed heavily on economic activity. Inverting the downward trend in investment, which continued in 2015, poses a major challenge.

3. **Significant internal and external imbalances remain.** The authorities have started a fiscal consolidation process, driven by revenue improvements. However, the composition of public expenditure worsened and public debt increased significantly, especially costly foreign borrowing (accounting for 63 percent of total debt). Headline inflation continues its decline, with core inflation (excluding food and energy) at a relatively high level but expected to drop in the coming months. Despite a significant improvement in the trade balance, due mainly to exceptionally strong agricultural exports and, to a lesser degree, falling world commodity prices, the current-account deficit remained stuck at about 8.9 percent of GDP (close to the 2014 level) because of declining tourism and remittance inflows. Disbursements from the AfDB and the World Bank and proceeds from an international bond issuance helped stabilize foreign exchange reserves at US$7.6 billion in 2015, a level that covers more than four months of imports.

4. **Longstanding structural challenges limit Tunisia's growth potential.** Binding growth constraints include: limited access to finance for small and medium enterprises (SMEs), a heavy regulatory burden, lengthy authorization processes, investment restrictions or tax incentives, lack of competition, inefficient government institutions, and depressed public investment. In addition, major external shocks have limited annual growth to 1.5 percent in the past five years, a level that is too low to reduce unemployment. The weak performance of state-owned enterprises' (SOEs) further dampens growth and their inefficiency acts as an additional drain on government finances.

Medium-term macroeconomic outlook

5. **The government's economic program aims to restore economic growth and gradually correct external and internal imbalances.** It calls for fiscal consolidation to stabilize and eventually reduce public debt, rebalancing of the budget towards high-priority investment expenditure, prudent monetary policy, greater exchange rate flexibility, and structural reforms. The

implementation of these reforms should re-start growth and cushion the impact of factors that weigh upon Tunisia's economy, especially those related to social and security tensions.

6. **Tunisia's economic performance is expected to gather pace over the medium term.** Growth in 2016 will remain modest (2 percent), but structural reforms, the easing of investors' wait-and-see attitude, and the reduction of social tensions should strengthen growth to an average of 4 percent (2017 to 2020). The overall downward inflationary trend should continue, assisted by prudent monetary policy. Fiscal consolidation will gradually reduce the structural budget deficit (i.e., deficit corrected for the economic cycle and excluding bank recapitalizing and civil service reform costs) by 2.2 percentage points of GDP by 2019, thereby stabilizing public debt at 51 percent of GDP. Tighter fiscal policy, combined with the gradual correction of the dinar's over-valuation and a recovery in Europe, should reduce the current-account deficit to 4.4 percent of GDP in the medium term. A stronger current account, a rebound in foreign direct investment following improvements to the business climate, and a significant volume of external financing will keep foreign exchange reserves above 100 percent of the Fund's ARA (assessment of reserve adequacy) index. This level covers more than four and half months of imports from 2016 onwards.

II. OBJECTIVES AND STRATEGY UNDER THE PROGRAM

7. **Our economic and reform program aims primarily to transform Tunisia's economy so that it can generate more inclusive growth and create jobs.** Our program is based on four pillars: (i) consolidating macroeconomic stability, a prerequisite for economic growth; (ii) reforming government institutions to improve service delivery, increase transparency, and reallocate public expenditure with a view to reducing regional and social inequalities; (iii) reforming the banking sector so that it can adequately support growth; and (iv) developing the private sector to create jobs, which is our highest priority.

8. **Our reform agenda is comprehensive, requiring dialogue, consensus, and closer coordination among the main stakeholders in the Tunisian economy.** We have therefore set up a unit in the Prime Minister's office to oversee economic reforms. It will have full coordination powers to ensure that reforms are carried out within the agreed timeline.

A. Consolidating Macroeconomic Stability

Fiscal policy

9. **The cornerstone of medium-term fiscal policy is to reduce public debt to a sustainable level while rebalancing the composition of the budget towards priority spending that can generate inclusive growth.** Our medium-term debt sustainability objective is to bring the overall fiscal deficit (excluding grants) to the equivalent of 2.4 percent of GDP by 2019 and stabilize the debt-to-GDP ratio at 51 percent. These projects include one-off costs related to civil service reform during the program's duration. Establishing a more equitable and effective tax system and reducing the wage bill to the equivalent of 12.7 percent of GDP by 2019 should create the necessary fiscal

space to increase investment to 7 percent of GDP. An increase of social transfers is also envisaged as part of a new social safety net.

10. The 2016 budget law initiates a fiscal consolidation process that reduces financing constraints, while reflecting urgent needs associated with security and social tensions. Accordingly, it had called for a structural fiscal deficit—corrected for the economic cycle and excluding bank recapitalizing costs—of approximately 3.6 percent of GDP. This deficit takes into account the impact of wage increases and new wage "agreements", a 16 percent increase in capital expenditure, a reduction in energy subsidies, and the implementation of the first phase of the tax reform (reducing exemptions and rationalizing customs duties).

11. A slight deviation from the budget target is envisaged in 2016 to address new needs arising from new security requirements and recent economic developments. Since the beginning of the year, we have faced additional, unforeseen costs of 1.2 percent of GDP, mainly due to security expenditures (0.4 percent of GDP), increases in security personnel (0.3 percent of GDP), expenditures on other goods and services (0.1 percent of GDP), and a transfer to the pension system (related to the delay in approving legislation which extends the retirement age) (0.4 percent of GDP). The impact of these costs—exacerbated by the decline in tax revenue (1.0 percent of GDP) and nontax revenue (0.3 percent of GDP) from the contraction of economic activity and the fall in oil prices—will only be partially offset by the reduction in energy subsidies (0.5 percent of GDP) and a profit transfer of 0.4 percent of GDP from the STIR (Tunisian Refineries Corporation) arising from lower global oil prices, the sale of 4G mobile telephone licenses (0.4 percent of GDP), lower unallocated expenditure (0.2 percent of GDP), and a rationalization of promotions and performance bonuses that keeps the wage bill in line with the budgeted level (0.3 percent of GDP). As a consequence, the structural fiscal deficit for 2016 will be 0.4 percent of GDP higher than implied by the budget.

12. We remain committed to taking additional measures to correct any deviation from our fiscal targets, including reducing current expenditures that have been a source of budget overruns in the past. Investment and social expenditures (excluding energy subsidies) will be protected and will not be constrained by our fiscal consolidation strategy.

13. Substantial budget support will be necessary to meet our financing needs. The 2016 budget will receive donor support from the World Bank (US$550 million), the African Development Bank (US$500 million), and the European Union (US$492 million in financing and US$96 million in grants). We also plan a bond issue of US$500 million in international markets with a guarantee from the United States' government. In light of the high cost of borrowing in international markets, greater use of the domestic debt market is also planned (approximately 2.3 billion dinars), although we will limit issuance to avoid crowding out private-sector credit. We request that the first disbursement of the IMF's Extended Fund Facility be allocated to the government's budget to alleviate expected cash-flow pressures during the first half of the year.

Monetary policy

14. The Central Bank of Tunisia (CBT) has recently pursued an accommodative monetary policy. The slowdown in private sector credit, a widening output gap (2.5 percent in 2015), and a downward inflationary trend led the central bank to lower its policy rate by 50 basis points in October 2015. Nevertheless, we are ready to tighten monetary policy to prevent any resurgence of inflationary pressures, particularly should core inflation increase because of a depreciating dinar or higher wages. Higher policy rates would also support positive real interest rates, which is one of the central bank's main objectives.

15. Reform of the monetary policy framework is ongoing. To anchor inflation expectations, we plan to gradually move towards a credible inflation-targeting framework in the medium term, once the prerequisites for the transition are met. The priorities are as follows:

- **Approval of the new CBT statutes.** To strengthen central bank independence, a new central banking law was approved by the Assembly of the People's Representatives (ARP) in April 2016 (prior action). That law confirms price stability as the central bank's overriding objective. A greater focus on communication will also be important to enhance the monetary policy framework.

- **Lender of last resort.** The implementation of a lender-of-last-resort (LOLR) facility by September 2016 will allow a differentiation of urgent liquidity operations from monetary policy ones. A framework agreement for loans granted under the LOLR was established in April with Fund technical assistance (TA). This mechanism will also contain risks to the central bank's balance sheet and delineate the justification for bank financing needs, which remain high (nearly 4.7 billion dinars, excluding FX swaps, at the end-March 2016). In tandem with that reform, we intend to sharpen the qualitative criteria used to rate refinancing collateral (including a revision of the proportion of treasury bills which may be used for that purpose) and, by June 2017 (with TA from the Fund), introduce ratings instruments to strengthen the existing haircut system, including for government securities.

- **Strengthening the monetary policy framework.** We initiated in April 2016 the drafting of a manual for monetary policy operations with TA from the Bank of France and Fund staff. With an expected implementation date of June 2017, the manual will streamline several texts that currently govern money market operations (intervention tools, operations, counterparties and eligible assets, penalties, discretionary measures) into a single manual for monetary policy operations. It will also tighten our collateralization system. By December 2016, our liquidity forecasting should improve thanks to the implementation of a system to analyze deviations from forecasts and adjust liquidity allocations.

- **Developing the interbank market,** based on four pillars: (i) introduction of a fixing system for interbank rates in December 2016; (ii) development of a yield curve by 2017, including the use of separate auctions by maturity; (iii) diversification of liquidity management instruments to include repurchase agreements; and (iv) introduction of interest-rate hedging instrument by June 2017.

16. Until a stronger monetary policy framework is in place, the program will retain a ceiling on the central bank's net domestic assets as a performance criterion. In coordination with Fund staff and depending on the progress made towards moving to an inflation-targeting framework, this criterion could be modified in future reviews to include a monetary policy consultation clause (MPCC). Using this clause will require that the pre-requisites for a credible inflation-targeting framework are in place (including a more flexible exchange rate).

Exchange-rate policy

17. The change underway in the operational framework of the foreign exchange market will encourage market deepening and allow for greater exchange rate flexibility. The regular foreign-exchange auction system, introduced in February 2016 with Fund TA, will help promote competitive bidding for foreign exchange, improve operational transparency, and reduce operational risk. The mechanism, in which nine banks are participating (90 percent of the market), will contribute to greater exchange rate flexibility and will further reduce our market interventions (already reduced from an average of 37 percent of the market in 2014 to 24 percent in the fourth quarter of 2015). The recent circular, which severs the link between interbank, trade, and financial operations, will further stimulate activity in the foreign exchange market. The circular also grants more flexibility to cover exchange and interest rate risk (forwards, swaps, and options) and for registered intermediaries to convert foreign bank drafts into foreign exchange (instead of converting only into dinars).

18. More exchange rate flexibility is essential to improve competitiveness, conserve the central bank's international reserves, and facilitate external adjustment. In addition to the ongoing measures listed above, we intend to make the exchange rate market more flexible by:

- **Limiting central bank interventions** in the foreign-exchange market to smooth out excessive fluctuations. Holding FX auctions will allow the exchange rate to be determined by market forces, among others. To that end, we are firmly committed to limiting net foreign-exchange sales, and that only if the market cannot supply the necessary foreign exchange. A more flexible exchange rate will help gradually correct the overvaluation of the dinar and improve alignment with macroeconomic fundamentals. We also plan to buy foreign exchange when market conditions permit;

- **Gradually making foreign exchange regulations more flexible as prerequisites are met.** The CBT Board of Directors has approved measures to encourage capital mobility over the medium term. Among these measures, which are key to facilitating investment and economic operations, are the following: (i) reducing ex-ante controls by the CBT with respect to capital operations and replacing them with ex-post controls; (ii) eliminating the cap on the amounts that foreigners can buy of government securities or securities issued by resident companies; (iii) removing all caps on foreign borrowing by domestic credit institutions and export-only companies, and raising the cap for all other enterprises (to 10 million dinars); and (iv) making foreign exchange operations more flexible by delegating certain transfer procedures to banks.

B. Reforming Government Institutions

19. The government is firmly committed to reforming government institutions. One of our high-priority objectives is to make the public administration more productive and to improve service delivery to citizens and enterprises. Better governance will also help sustain growth. Reforms to the civil service, public-sector enterprises, tax policy and administration, pension funds, and social safety nets are essential to improve the efficiency and effectiveness of public services and to enhance the management of government expenditure and government debt. Fighting corruption will be part of all our reforms (see below).

20. Restructuring the civil service remains a top priority to improve the efficiency and effectiveness of the public administration and contain the wage bill. By September 2016, we will adopt a civil service reform strategy aimed at (i) redefining the government's functions, duties, and responsibilities, (ii) establishing statutes for the senior civil service in addition to the ongoing revision of general status, (iii) redeploying officials between ministries and regions to optimize government activities according to needs, (iv) reducing staff numbers (including by voluntary separations and no replacement of those who leave), (v) updating the civil service recruitment process, (vi) reviewing the salary and benefits structure, and (vii) redefining civil service performance evaluation and career paths. This strategy, consistent with our objective of reducing the wage bill to the equivalent of 12 percent of GDP in 2020 (53 percent of tax revenues) will be adopted by the Council of Ministers by end-September 2016 (structural benchmark). Broad discussions initiated at the national employment conference in March 2016 will help develop a consensus on the main objectives and components of the strategy. The strategy will set out the main reform areas, specific action plans, deadlines, expected results, and the government entities responsible for implementation of each action. Although specific measures remain to be determined, we are committed to ensuring implementation by:

- **Maintaining the hiring freeze** in all ministries through the next three years, with the exception of urgent needs for security and defense personnel. This measure will also be assessed over the next two years to ensure that the large number of retiring civil servants from 2018 onward will not create staffing distortions and a lack of experienced personnel in public administration;

- **Containing the increase in the 2017 wage bill to no more than the rate of inflation**, i.e., 4 percent. This goal implies taking measures to cut spending equivalent to 0.6 percent of GDP. These measures will be established in the 2017 budget, and may include a menu of options, among them the harmonization and rationalization of benefits and performance bonuses and the suspension of promotions.

- **Facilitating the redeployment of staff to regions outside the capital.** Carrying out this measure will require a review of ministries' functions and responsibilities. The reviews for four ministries (the Ministries of Health, Education, Finance, and Infrastructures), which account for over half of all the country's civil servants, will be completed by December 2016 (structural benchmark). By December 2016, the government intends to review the legal framework for redeploying civil servants and other government personnel to help implement the results of the functional reviews. In 2017, functional reviews will also cover all other ministries beyond the first four, which will define duties and responsibilities, recruitment requirements, staff reallocation, and budget cost structure of each ministry.

- **Developing a voluntary separation program.** In parallel with our redeployment efforts, we will examine the possibility of carrying out a voluntary separation program beginning in 2018. Technical and financial assistance from our development partners will be requested to support us in this effort.

21. Strengthening the oversight of state-owned enterprises (SOEs) and restructuring them will improve the quality of their service delivery and ensure their financial viability over the medium term. The strategy we adopted in October 2015 is based on promoting good governance in the public sector and fully acknowledges the government as a shareholder. It also strengthens internal governance and supports financial restructuring of SOEs. To that end, we will establish by January 2017 an agency to manage the government's corporate shareholdings, oversee SOE restructuring programs (including the banks in which the government has equity stakes), and overhaul their governance. All the other bodies that have up to now reported to the Prime Ministry or the Ministry of Finance and who are responsible for overseeing SOEs under restructuring will be grouped together under a supervision and coordination committee. In the meantime, we will finalize performance-based contracts that will rely on management and financial indicators for the five largest public-sector enterprises—STEG (Société Tunisienne de l'Électricité et du Gaz), STIR, the Office des Céréales (National Grain Board), Tunisair, and the Régie Nationale des Tabacs (National Tobacco Company) (end-September 2016 structural benchmark). We will also produce a list of all arrears between SOEs and the State by December 2016 and between all SOEs by June 2017. In addition, the internal governance of SOEs will be strengthened by professionalizing their boards of directors, starting with the five largest. In parallel with these reforms, the government's shareholdings will be reviewed in order to identify nonstrategic sectors and sectors where the government's stake could be divested.

22. Reforming energy subsidies will enable us to lock in savings from the drop in world oil prices and create the necessary fiscal space to cover high-priority expenditures. The first part of this reform centers on establishing a symmetrical, automatic adjustment formula for petroleum products (gasoline, diesel fuel), which will be adopted in May 2016. This mechanism will be implemented in stages starting from July 2016 on a quarterly basis, then increasing onwards to a monthly basis from January 2017, to be gradually extended to other petroleum products (natural gas, kerosene). The new pricing scheme will accompany the establishment of new minimum social-protection safety nets (see below). The second part of the reform will focus on electricity subsidies, with rates to be reviewed in 2017 (while maintaining a lifeline tariff to protect disadvantaged segments of society) and eliminating subsidized tariffs for all manufacturing and industrial sectors (as was the case for cement plants in 2014).

23. An adequate tax system, together with a modern tax administration, is crucial for promoting inclusive growth. We plan to achieve this objective by:

- A **tax policy reform** aimed at strengthening revenue collection and the fairness and transparency was initiated through the rationalization of VAT exemptions, reduction in the number of customs tariff rates, and closing the gap in corporate taxation between on-shore and off-shore businesses. To clearly communicate our vision to the public, the full strategy—including the harmonization of VAT rates, a further reduction of exemptions, a more progressive personal income tax (IRPP) with lower rates for low-income people, and revised allowances and deductions, together with the timetable for implementing these reforms—is expected to be approved by the Council of Ministers in May 2016 (prior action) and subsequently published.

- **A modern, efficient, and fair tax administration.** A new tax administration in line with international practices will be designed over the next 12 months with the aim of establishing an integrated and modern tax administration system within the next three to five years. In the short term, the Large Taxpayer Unit (LTU, which collects about 55 percent of tax revenues) will be reformed by December 2016 (structural benchmark) to include formal responsibility for major tax and enforcement functions (return processing, taxpayers advisory services, and audit). The LTU will also be responsible for closely monitoring and reporting on the arrears of large taxpayers using monthly information from the Public Accounting and Collections Directorate (DCPR), thereby ensuring that the largest taxpayers fully meet their tax obligations. In addition, a pilot medium-sized taxpayer office (MTO)—modeled on the reformed LTU model—will be established in the greater Tunis area by June 2017. Three other MTOs will be established throughout the country in 2017–18. In parallel, we will continue to work on implementing risk-based and selective audit programs across all segments of taxpayers, increase our efforts to identify and bring into compliance taxpayers currently in the informal sector, and improve services to compliant taxpayers.

24. Our economic reforms will be accompanied by a better targeted social protection system. To support the most vulnerable, a sustainable, effective, efficient, and transparent social protection system is essential. Once implemented, the scope of the system can be broadened quickly. Our main priorities are:

- A **targeted social safety net** based on data containing information on vulnerable families with limited incomes, which will be finalized by March 2017 (structural benchmark) using the findings of field surveys conducted in 2016. This system will be based on a new, unique social identifier which will be finalized once the lists of social assistance program beneficiaries have been cross-checked, with the aim of eliminating the fragmentation of social-protection safety nets. We intend to expand the coverage of this unique social identifier beyond vulnerable families with limited income to those registered in the existing social security system (8.3 million people) and beneficiaries of reduced-rate health care cards, which will help us define a new well-targeted social safety net by June 2017.

- A **pension scheme** that is more comprehensive and financially viable, to ensure people's security in retirement. Initially, adopting a voluntary increase in the retirement age in 2016 should smooth out short-term imbalances in the National Retirement and social Security Fund (CNRPS), which has no available cash reserves and will post an annual deficit of 0.4 percent of GDP. Discussions within the National Council on Social Dialogue—which will be established in May 2016 once the national assembly has approved its creation—are planned in order to completely overhaul the system by 2017, reestablishing the CNRPS' financial viability. The key elements of the reform will focus on reviewing the parameters for calculating pensions (e.g., the replacement rate), the rate of contributions, and benefits. Developing this strategy will take into account the guidance defined by the reform of the civil service.

25. More effective public financial management is needed to increase transparency and good governance and assure the efficiency and effectiveness of public services. Our actions will focus on three main areas:

- **A new organic budget law.** This law, to be published in the official gazette in December 2016 (structural benchmark), will ensure that the budget is better designed. It will provide additional budget information (new functional classification), allow for tighter control on expenditures, and simplify budget execution and monitoring procedures. It will also entrench performance-based budgeting, with 18 ministries (85 percent of the budget) already preparing their budgets according to the new classification and a multiyear framework.

- **Cash-flow management.** Coordination will be strengthened between the Directorate General of Debt, the Treasury, and other units in the Ministry of Finance to improve cash flow management. This will be supported by monitoring a Treasury Single Account (TSA) that would only regroup sub-accounts that relate to central government. The management of TSA operations will benefit from Fund TA.

- **Reform of the public investment framework** to make it more effective and help accelerate public investment to 7 percent of GDP by 2020. The overhaul of the procurement system has started to show results with a 76 percent increase in new contracts awarded in 2015. At the same time, increased flexibility in reallocating investment expenditures from stalled to viable projects has helped improve the execution rate on investments to 90 percent in 2015. We will continue to identify constraints on, and introduce flexibility in, the execution of investment projects, especially in the most marginalized areas. Better planning, monitoring and follow-up in the regions will go hand in hand with the redeployment of staff, a main element of the civil service reform. Our priorities include identifying high-priority projects to be included in the 5-year development plan, simplifying procedures, accelerating the establishment of an evaluation and monitoring system for government projects at the regional and national levels, and reducing land-deed constraints.

26. Our debt management will be strengthened throughout the program. With TA from the World Bank, we will finalize a medium-term debt strategy by the end of December 2016 (structural benchmark) with the aim of strengthening debt management and minimizing costs, optimizing the composition of domestic and external debt, and ensuring debt sustainability. In coordination with the capital market development strategy, we will finalize an action plan by June 2016 to establish a debt management agency in 2017, which will have the authority to analyze fiscal risks and financing options. The agency will also closely monitor risks arising from guarantees (currently equivalent to about 12 percent of GDP). To help deepen the domestic market, we will publish the timetable of regular auctions of government securities with three months' advance notice. We will also examine the possibility of issuing short-term treasury bills.

27. Stepping up the fight against corruption and increasing transparency will help the government fulfill its accountability responsibility to citizens and contribute to a better understanding of the reform impact. Improving electronic access to information and public services and reforming statistics are critical.

- **Reforming the anti-corruption framework.** The government is currently drafting a law to be approved no later than December 2016 (structural benchmark) to set up an independent "high-level constitutional body to fight corruption and promote good governance," which will be adequately resourced with criminal investigatory powers and access to relevant information to perform its functions. In the meantime, the government will issue a decree strengthening the oversight powers of existing "good governance units". Three additional laws are under preparation: (i) protection for whistleblowers (citizens who report corruption cases in government services), (ii) conflicts of interest in the public sector, and (iii) financial disclosure of net worth by senior government officials. The government will also continue to strengthen the AML/CFT framework to address corruption risks, specifically by implementing enhanced customer due diligence measures for domestic politically exposed persons in line with the FATF standard, and strengthening AML/CFT supervision" helped by the work of two commissions set up by the new August 2015 Anti-Terrorism and Money Laundering law

- **Reforming the system for data production, dissemination, and access.** In December 2015, a citizens' budget was published online for the first time. Tunisia has joined the "open government initiative", and the Ministry of Finance recently put the Mizaniatouna portal online to disclose budget performance. A draft organic law on access to information was voted by the ARP in March 2016, with its implementation decrees to be finalized by September 2016. This law will establish and facilitate access to government data. Moreover, a national e-Gov plan will bring government services in a unified portal online.

- **Reforming the statistics system.** Eurostat has completed a comprehensive diagnosis of our statistics system, and efforts to strengthen our national accounts statistics (both yearly and quarterly) are under way. Our reform strategy is aimed at consolidating the governance of the statistics system, modernizing the production of statistics, and maintaining quality standards. Our strategy will require substantial capacity-building for the National Bureau of Statistics (INS), a new National Statistics Charter, and the drafting of a new statistics law (in lieu of the 1999 law)—to be presented to the government in December 2016—to guarantee the independence of published statistics. It will strengthen the CBT's statistical and analytical capacities, including for the consolidation and modernization of monetary and balance-of-payments statistics. We are also committed to publish within agreed timelines the statistics required in support of industrial and employment policies, or for establishing national accounts. In this regard, the five-year household consumption survey will be completed in June 2016 and published no later than December 2016.

C. Financial Sector Policy

28. The soundness of the banking sector has improved, but vulnerabilities remain. Three public banks have recently been recapitalized, increasing the solvency ratio of the sector as a whole from 9.4 percent in December 2014 to 12.2 percent in December 2015. All the banks (except for the Banque Franco Tunisienne and a large public bank (BNA)) were in full compliance with the 10 percent regulatory minimum at end-2015. Credit growth slowed to 5.8 percent at end-February 2016. Deposit growth in 2015 was half that of 2014 (November to October), which affected liquidity and caused excessive recourse to central bank refinancing, particularly in the case of one public bank that was not in compliance with the minimum liquidity ratio. With respect to nonperforming loans, in spite of some progress in resolving them, they remain high at about 16 percent of total loans, but covered to 65 percent by provisions.

29. We have pursued our reform program to stabilize and strengthen the banking sector. To coordinate future reform commitments, a committee chaired by the Minister of Finance has been set up in April 2016, bringing together various stakeholders involved in financial sector reforms. The committee will monitor progress on reform implementation, and identify areas for further action. The committee will liaise closely the coordinating unit established in the Office of the President for major reforms. Significant progress has already been made in the following areas:

- **Public banks.** The three public banks were recapitalized in 2015 to bring them into line with prudential standards, including the solvency ratio and provisioning requirements highlighted in audits conducted from 2013–15. For the three banks, updated versions of their restructuring plans will be approved by their boards of directors by May 2016 (prior action). These updates take into account the new economic outlook.

- **Legislative and regulatory framework.** The laws concerning the central bank statutes and bankruptcy procedures were approved in April 2016, with the law on banks and financial institutions (hereinafter referred to as the banking law) to be approved by Parliament in May 2016 (parliamentary approval of all three laws are prior actions), in line with good international practices.

- **Banking supervision.** Building on the progress over the past two years, the process of strengthening banking supervision continues. In 2015, penalties were systematically applied to banks that failed to maintain prudential ratios; general and thematic on-site inspections were conducted, especially those related to credit risk management; and the intermediate steps necessary to implement automated reporting and establish a rating system for lending institutions (SYNTEC) has been implemented.

30. We are stepping up our efforts to reform the financial sector in order to reduce its vulnerabilities. Reforms will focus on four priorities:

- **Strategic and operational restructuring of the three public banks.** After the recapitalization, public banks have begun a process of operational restructuring; in the last quarter of 2015 the banks' board of directors appointed new management. We will ensure the banks implement the restructuring plans approved by their boards of directors. The goals of the restructuring plan will feed into performance-based contracts (which monitor indicators such as the cost-to-income ratio and the restructuring of nonperforming loans, all on a consolidated basis including the banks' various subsidiaries) to accompany the restructuring (2016 end-June structural benchmark). In the medium term, the government will allow technical and strategic partners to purchase equity in the three banks by selling significant parts of its own stake, in order to strengthen banking expertise within the institutions and improve their governance. With respect to other minority stakes in banks held by the government, a divestment strategy is in progress.

- **Resolving nonperforming loans (NPLs)** is based on the following priorities: (i) implementing the bankruptcy law with the issuance of decrees setting out the corresponding implementing provisions by September 30, 2016, including a training program for officers of the court in the competent jurisdictions; (ii) setting up units within each public bank that specialize in NPL management by June 2016 to ensure that they are handled adequately; (iii) placing the governance structures of public banks on an equal footing with those of private banks by amending by December 2016 legal texts forbidding public banks from writing off nonperforming loans; (iv) adopting by December 2016 a new amendment to the law on credit recovery companies, allowing them to renegotiate NPLs directly with customers; and (v) simplifying the conditions whereby credit institutions can remove from their balance sheet unrecoverable loans that are fully provisioned (December 2016, as part of the budget law).

- **Strengthening risk-based supervision.** We will ensure that the 2015–20 action plan of the central bank's Directorate General of Banking Supervision (DGSB) is implemented, placing emphasis on meeting the plan's timeline. The plan has three main components:

  - **Overhauling the regulatory framework** to implement supervision based on the Basel Committee's three pillars (minimum capital requirements, supervisory review process, and market discipline). The framework will imply the adoption of CBT circulars on operational risk June 2016 and market risk the first quarter of 2017, with the support of technical assistance, and a regulatory guidance in September 2016 setting out qualitative standards that must be adhered to by the banks' internal ratings systems pursuant to circular 2006–19, thereby imposing the implementation of rating systems within the banks. By June 2016, the CBT will have comprehensive information on banks' intra-group transactions, including minority and nonfinancial holdings. Supervision will be carried out on a consolidated basis from the second half of 2018, unless the above-mentioned "reporting" information requires another prioritization and revision of the calendar. Lastly, the CBT will issue a circular in June 2016, whereby the lowering of the authorized maximum exposure vis-à-vis related parties will be phased in over two years, to 50 percent of a bank's Tier 1 capital at year-end 2017, and 25 percent at year-end 2018.

- **Developing the DGSB's operational capacities and information systems.** The SYNTEC system will link the supervisory intensity to banks' risk profiles, and a risk-based supervision manual will be applied systematically starting in December 2016 (structural benchmark). To optimize banks' data collection and treatment, reporting will be entirely automated from September 2016 onward. The DGSB's capacities will be strengthened by recruiting a dozen supervisors (in addition to the 10 already planned) for this specific purpose (with a closing date for applications no later than June 30, 2016).

- **Increasing on-site inspections over the next three years** and conducting at least seven general and/or thematic inspections a year as additional resources become available. In particular, by March 2017, the CBT will have conducted inspections in the seven largest private banks to verify that frameworks for credit risk management and provisioning meet best standards. The private banks' inspection program will take account those missions carried out in 2015 in two private banks. These seven inspections will be conducted with support from Fund TA and on the basis of terms of reference agreed upon with the CBT (completion of the seven inspections is a structural benchmark for end-March 2017). Moreover, the DGSB will continue to conduct inspections focusing on other prudential concerns (in particular, combating money laundering and monitoring the restructuring of the public banks)

- **Implementing the bank resolution framework and the deposit guarantee fund contained in the new banking law.** Implementation decrees for bank resolution and the deposit-guarantee fund will be adopted by September 30, 2016. The new rules will apply to all banks covered by the new resolution mechanism.

31. To promote financial inclusion and improve access to credit for SMEs and individuals, we will take the following three initiatives:

- **Developing a legal framework for private credit bureaus.** The regulatory framework for the operations of credit bureaus and the central bank's monitoring of their activities will be established in a separate organic law. Establishing private credit bureaus will complement the central credit register maintained at the CBT, allowing banks to better assess risk and grant loans, and reduce lending rates. Customers will be able to more easily switch between banks as part of a competitive marketplace. The new law on credit bureaus is expected to be adopted by Parliament in June 2016.

- **Reviewing the rules regarding the effective cost of borrowing and raising the cap on excessive lending rates.** This reform will be carried out in two phases. First, by December 2016 we will increase the allowable spread between the maximum lending rate allowed and effective rates on loans to at least the same level as it was in 2009 (i.e., 33 percent) (structural benchmark). By June 2017, we will finish overhauling the legal framework governing excessive interest rates by setting the threshold according to the borrower's profile (large enterprises, SMEs, professionals, individuals, etc.) rather than type of loans.

- **Streamlining government's support for the economy by establishing a Bank of Regions (BdR),** which will allow the government to support economic initiatives that the private sector does not finance. A number of public entities (the Banque Tunisienne de Solidarité [Tunisian Solidarity Bank], the Banque de Financement des Petites et Moyennes Entreprises [SME Financing Bank], the Caisse des Dépôts et Consignation [Savings and Loan Bank], and the Société Tunisienne de Garantie [Tunisian Guarantee Company]) are currently in charge of providing finance for developmental purposes. Some of these entities will be brought together within the BdR, for which the business model is currently being developed. The BdR should be set up by March 2017 with technical support from the KfW German development agency. The BdR's financing solutions (loans, guarantees, etc.) will be offered in partnership with commercial banks.

Structural reforms

32. A favorable business climate is necessary to unleash the potential of the private sector in driving growth and creating jobs. Our first priority is to improve the regulatory framework to allow greater competition, promote market access, protect investors' rights, and encourage transparency. This will require issuing and implementing decrees to operationalize the three laws listed below (structural benchmark for the end-September 2016):

- **The competition law.** The implementation of this law, approved in September 2015, will encourage competition and reduce government intervention by (i) strengthening the advocacy powers of the Competition Board, (ii) defining the duties and responsibilities of the Competition Board and the ministry with regard to competition-related issues, (iii) reducing the deadlines (from six to three months) in which the Ministry of Trade and Commerce reviews proposed concentrations of ownership or mergers submitted by relevant companies, and (iv) strengthening enforcement by increasing company fines from 5 to 10 percent of their turnover if they are in violation of competition laws.

- **Public-private partnerships (PPPs).** Approved in November 2015, the law will be operative once the implementation decrees have been finalized. The government is making PPPs operational through feasibility and budget risk assessments, particularly for two pilot projects in the water and infrastructure sectors. Once the law becomes effective, it will be supported by a monitoring framework for budget risks associated with PPP projects.

- **The investment code.** Approval of the investment code will establish a more transparent regulatory framework. The code will better protect investors, significantly improve investment governance, and promote greater market access, particularly through a program to reduce the number of permits and authorizations required over the next five years. It will also ensure consistency between the country's development objectives and the investment incentives, with tax incentives to be consolidated into the tax code. The government has drafted three implementation decrees that will be issued at the latest by September 2016 once the ARP has adopted the investment code.

33. We will continue to streamline administrative procedures and regulations. We have already streamlined about 376 customs and tax formalities and 154 administrative procedures, considered as priorities for private sector activity in the areas of transport, commerce, industry, justice, agriculture, social affairs, and land (and state-owned property) affairs. An impact study of the streamlining has started, and once complete in June 2016, we plan to initiate a third streamlining phase of 372 administrative procedures in the areas of housing infrastructure, territorial planning, healthcare, environment, tourism and interior. This stage will be carried out over the next two years.

34. We are committed to reducing labor market frictions. The National Dialogue on Employment, held in March 2016 in Tunis, resulted in a consultative dialogue and an analysis of job market developments. It helped establish a consensus amongst stakeholders on measures for the short and medium term. Following the conference, and with technical assistance from the International Labor Organization, we intend to develop by the first quarter of 2017 a national employment strategy that will: (i) improve the employability of job seekers, (ii) develop local SMEs, and (iii) reform vocational training so that, among other things, vocational training centers are more independent and have better governance. Lastly, we intend to speed up our efforts to implement work programs and support micro-projects that favor the youth and underprivileged areas

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

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

	Cumulative flows since beginning of 2015 (unless otherwise specified)	Cumulative Flows Since Beginning 2016 (unless otherwise specified)				Cumulative flows since beginning of 2017 (unless otherwise specified)	
	December 2015	March 2016	June 2016	September 2016	December 2016	March 2017	June 2017
	Projection	Projection	Proposed QPC/target	Indicative target	Proposed QPC/target	Indicative target	Indicative target
Quantitative Performance Criteria							
1. Floor on the primary balance of the central government (cash basis excl. grants; million of Tunisian dinars)	-3,246	-274	-1,209	-1,699	-2,326	-814	-676
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock; million of Tunisian dinars)	1,924	3,220	4,887	3,498	2,191	2,363	2,826
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock; million of US dollars)	4,488	3,907	3,599	4,261	4,762	4,773	4,523
4. Ceiling on Current Primary Expenditure (million of Tunisian dinars)	18,088	5,189	9,539	14,497	19,724	5,244	9,637
Continuous Performance Criteria							
5. Ceiling on the accumulation of new external debt payment arrears by the central government	0	0	0	0	0	0	0
Quantitative Indicative Targets							
Floor on Social Spending 3/ (million of Tunisian dinars)	1,335	262	626	926	1,534	285	683
Ceiling on the accumulation of new domestic arrears	0	0	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/	1,507	75	309	1,308	2,352	475	1,300
of which: Multilateral (excluding IMF), bilateral and budget grants (in US$ million)	1,370	0	159	626	1,635	400	800
Public external debt service (interest and amortization) on a cumulative basis (in US$ million)	961	230	511	811	1,113	270	1,175
Bank recapitalization and civil service reform costs (in million TD)	647	0	0	0	0	0	0
Privatization receipts in FX (in US$ million)	0	0	0	0	0	0	0
Resident deposits at the BCT (in US$ million) 5/	1,269	1,269	1,269	1,269	1,269	1,269	1,269
Foreign exchange swaps between the CBT and commercial banks (in million TD) 5/	603	603	603	603	603	603	603
Program exchange rate TD/ U.S. dollars	2.01285	2.01285	2.01285	2.01285	2.01285	2.01285	2.01285

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/ Disbursment, includes project loans and capital market access but excludes IMF.

5/ At program exchange rate.

Table 2. Tunisia: Proposed Prior Actions and Structural Benchmarks

Prior actions	Objective	
Approval, by banks' boards, of the updated business plans for all three public banks.	*Financial sector stability*	
Adoption, by the Assembly, of the People's Representatives (ARP), of the CBT law, the banking law, and the bankruptcy law in line with good international practices.	*Ensure financial sector stability, modernize monetary regimes, and support inclusive growth and job creation*	
Adoption, by the Council of Ministers, of the comprehensive tax reform strategy, in line with the principles of fairness and efficiency agreed with IMF staff.	*Fiscal sustainability and fairness*	
Proposed structural benchmarks	**Objective**	**Date**
I. Financial sector reform		
Approval, by the board of Directors of public banks (STB, BH, and BNA), of performance contracts in line with their new restructuring plans.	*Financial sector stability*	Jun-16
Increase of the cap on lending rates to, at least, the 2009 level.	*Financial sector stability*	Dec-16
Systematic use, by the supervisors, of the new manual on risk-based supervision.	*Financial sector stability*	Dec-16
Inspection of the seven largest private banks in line with the best standards and with IMF Technical Assistance as agreed with the CBT.	*Financial sector stability*	Mar-17
II. Budget Policy and Reforms of Public Institutions		
Approval, by the Council of Ministers, of a comprehensive strategy on civil service reform.	*Fiscal sustainability and fairness*	Sep-16
Signature of performance contracts for the five largest public enterprises.	*Better monitoring of fiscal risks*	Sep-16
Completion of the functional review of four ministries (Health, Education, Finance, and Infrastructure).	*Fiscal sustainability and quality public services*	Dec-16
Publication, in the official journal, of the organic budget law.	*Fiscal sustainability and fairness*	Dec-16
Establishment of a Large Taxpayers Unit to include formal responsibility for the major tax and enforcement functions (return processing, taxpayer advisory services, and audit).	*Fiscal sustainability and fairness*	Dec-16
Adoption of a medium-term debt strategy.	*Debt sustainability and deepening of financial markets*	Dec-16
III. Sectoral reforms/private sector development		
Adoption of the implementation decrees for the new law on competition, law on PPPs, and new investment code.	*Inclusive growth and job creation*	Sep-16
Creation of an independent, high anti-corruption authority.	*Good governance and fairness*	Dec-16
Establishment of a databank on vulnerable households.	*Social protection and fairness*	Mar-17

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 under the program supported by the Extended Fund Facility. 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 May 2, 2016. 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, 2015, as shown in the table below. For the SDR, the program exchange rate is 1 SDR = 2.797590 Tunisian dinars.

Program Exchange Rates, Tunisian Dinars per FX Currency at End-December 2015
(Accounting exchange rate of the CBT)

Currency	Exchange rate
AED	0.54802
BHD	5.3373
CAD	1.45005
CHF	2.0322
DKK	0.2947335
DZD	0.01878
EUR	2.1993
GBP	2.9837
JPY	0.0167135
KWD	6.63225
LYD	1.44535
MAD	0.203175
NOK	0.228923
QAR	0.552815
SAR	0.53634
SEK	0.23918
USD	2.01285

3. Monetary gold assets will be valued, against the corresponding value in Dinar (at the program exchange rate) at the price of 2,138.15 dinar per ounce of gold in the international market on 12/31/2015 (London morning fixing). The stock of gold is 4.13 tons (4,129,806 grams) on December 31, 2015.

4. For data reporting purposes, the Ministry of Economy and Finance (MoF), the Ministry of Planning and Economic Cooperation (MDCI), 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 performance criterion (**ceiling**) on total primary current expenditure of the central government.
- A continuous performance criterion on the accumulation of new external debt payment arrears (**zero ceiling**).

Indicative targets

- An indicative target (**ceiling**) on accumulation of new domestic arrears.
- 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 semi-annual basis. The performance criteria on the central government deficit on the total primary current expenditure of the central government are measured on a semi-annual 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 new external arrears is measured on a continuous basis. Indicative criteria will be monitored on a quarterly 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 March 31, 2016.

[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 programs, it is agreed: (i) to retain the accounting definition of external liabilities used in the CBT balance at December 31, 2015; (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 operations in foreign currency (including deposits and derivatives products) created or included in reserve money and resulting in a liability of the Central Bank to residents. At end-December 2015, the value of the stock of deposits in foreign currencies of residents at the CBT, including swaps, was US$1268.8 million at the program exchange rate.

12. 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, 2015, the value of the stock of net international reserves was US$4,487.5 million, with the stock of reserve assets equal to $7,496.6 million and the stock of CBT liabilities in foreign currency equal to US$3,009.2 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 excluding cash balances of banks and the Treasury); (ii) deposits of 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 excluding the sub accounts N-bis, those related to Public Administrative Entities (EPA) and to local governments; (ii) Tunisian government account (miscellaneous dinar accounts); (iii) loan accounts; (iv) grant accounts; (v) FONAPRA-FOPRODI accounts; (vi) special accounts of the Tunisian government in foreign currency; (vii) accounts in foreign currency pending dinarization (subaccount: "mise a disposition"); (ix) and any other account that may be opened by the central government at the CBT or banks. 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.

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. In particular, any use of cash from non-banking institutions (including La Poste) to finance the Treasury would be counted as domestic non-bank financing. 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 Central Government Primary Current Expenditure (excluding Interest Payments on Public Debt)

23. 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[2].

G. Ceiling on the Accumulation of External Arrears

24. 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*[3] by the central

[2] 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.

[3] 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

(continued)

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

H. Indicative Ceiling on the Accumulation of Domestic Arrears

25. 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 beyond 90 days or more after the date on which the contract was signed or upon receipt of the invoice.

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 Ministries of Women and Family Affairs, Youth and Sports and Social Affairs, and all new targeted cash transfers in support of vulnerable groups; 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

27. The **NIR** targets are adjusted upward (downward) if the cumulative sum of net external financing of the central government , the sum of budgetary grants, privatization receipts received in foreign currency, the increase (decrease) in the residents' foreign currency deposits at the CBT (including FX swaps) are greater (lower) than the levels observed 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 lower (greater) 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, the sum of budgetary grants, privatization receipts received in foreign

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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.

currency, the increase (decrease) in residents' foreign currency deposits at the CBT are lower (greater) than the levels indicated in the table below. 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 targets are also adjusted upward (downward) based on downward (upward) change in the stock of foreign currency swaps between Central bank and the commercial banks compared to the level on December 31, 2015 (US$299.4 million, 602.65 million Tunisian dinars). The NDA ceiling will be converted into Tunisian dinars at the program exchange rate.

Program Assumptions on Adjustment Factors for the Quantitative Performance Criteria

(In million of US dollars)

	2016					2017				
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Official External Financing	75.0	551.0	999.0	1,361.0	2,985.9	475.0	1,143.2	75.0	893.2	2,586.4
Project loans	65.0	65.0	65.0	65.0	260.0	75.0	75.0	75.0	75.0	300.0
Multilateral donors	-	476.0	419.0	1,281.0	2,175.9	400.0	568.2	-	318.2	1,286.4
AFDB	-	-	200.0	300.0	500.0	-	-	-	-	-
AMF (Arab Monetary Fund)	-	-	-	-	-	-	-	-	-	-
IMF (budget support starting 2017)	-	317.0	-	317.0	633.9	-	318.2	-	318.2	636.4
World Bank Group	-	50.0	-	500.0	550.0	400.0	-	-	-	400.0
European Union	-	109.0	219.0	164.0	492.0	-	250.0	-	-	250.0
Bilateral donors	-	-	-	-	-	-	-	-	-	-
Financial Market Access and other	10.0	10.0	515.0	15.0	550.0	-	500.0	-	500.0	1,000.0
Sukuk and other market financing	-	-	-	-	-	-	500.0	-	500.0	1,000.0
Market issuance with US Treasury guarantee	-	-	500.0	-	500.0	-	-	-	-	-
Loan Transfers to SOEs	10.0	10.0	15.0	15.0	50.0	-	-	-	-	-
Budget Grants	-	-	47.7	45.4	93.1	-	150.0	-	0.9	150.9
Privatization Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government External Debt Service	206.5	280.9	282.5	282.6	1052.5	265.9	807.1	445.7	332.2	1851.0
Amortization	103.1	188.2	153.8	224.8	669.9	142.2	725.1	327.4	282.9	1477.5
Interest	103.4	92.7	128.7	57.8	382.6	123.7	82.1	118.4	49.3	373.5
Bank recapitalization and one-off costs linked to the civil service reform	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FX swaps between the CBT and the commecial banks	299.4	299.4	299.4	299.4	299.4	299.4	299.4	299.4	299.4	299.4
FX swaps between the CBT and the commecial banks (in million of Tunisian dinars)	602.7	602.7	602.7	602.7	602.7	602.7	602.7	602.7	602.7	602.7
Resident deposits at the BCT, including FX swaps	1268.8	1268.8	1268.8	1268.8	1268.8	1268.8	1268.8	1268.8	1268.8	1268.8

Sources: Tunisian authorities and IMF staff estimates.

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 and all amount used to finance the severance pay of the voluntary departures which may be part of the civil service reform.

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 these data and any data revisions previously transmitted to the IMF Resident Representative's office in Tunisia.

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***	***Responsible department***
GDP: Supply and demand at current, constant, and the previous year's prices, including sectoral indices.	*q*	*45*	*INS*
Inflation: Including the underlying inflation of non-administered and administered prices.	*m*	*14*	*INS*
Fiscal Sector			
Tax and nontax revenue of the central government decomposed on the basis of main tax and nontax revenues items	*m*	*30*	MoF
Total expenditures: current and capital, transfers and subsidies.	*m*	*30*	MoF
Capital expenditure: by type of financing: domestic and external (differentiating loans and grants), and by main sectors and projects (agriculture, social, infrastructure).	*m*	*45*	MoF
Current expenditure: by type of expenditure: wages, goods and services, transfers.	*m*	*45*	MoF
Social expenditure	*q*	*45*	MoF
Domestic and foreign debt			MoF
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*	MoF
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*	MoF

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*	MoF
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*	MoF
External payment arrears: external debt contracted and guaranteed by the government.	*q*	*30*	MoF/ CBT
Debt rescheduling: possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	*q*	*45*	MoF
Consolidated accounts of the central government at the CBT: The stock of deposits will be broken down as follows: (i) Treasury current account; detailed by sub accounts of the central government, N BIS, outstanding payments, Public administrative entities (EPA), and local governments (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) Foreign exchange accounts pending adjustment in dinars (available).	*m*	*30*	*CBT* MoF/TGT for sub-account
External Sector			
Imports of Petroleum Products: average import price and volume of main petroleum products.	*m*	*30*	*CBT*
Deposits: Stock of foreign currency deposits, according to the residence of the holder.	*m*	*14*	*CBT*
External debt: Debt service (amortization and interest) of institutional agents by type of currency (in foreign currency and its equivalent in dinars). Stock of external debt of institutional agents by type of currency (in foreign currency and its equivalent in dinars). Overall net external position of Tunisia (in conformity with our obligations under SDDS).	 *q* *q* *A*	 *30* *90* *180*	 *CBT*
Balance of payments: Prepared by the CBT	*q*	*30*	*CBT*

Monetary and Financial Sector			
CBT accounts at the current exchange rate: detailed table including the monetary system.	*m*	*30*	*CBT*
CBT accounts at the program exchange rate: Including net international reserves.	*m*	*30*	*CBT*
Foreign exchange market operations, Interbank market, retail market and wire transfers for CBT purchases on the retail market: CBT Interventions (sales and purchases) on the foreign exchange market in million of dinars (and equivalent in US million) including the CBT share in percentage of the market transactions, 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.	*m*	*30*	*CBT*
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*	*CBT*
Direct refinancing of commercial banks by the CBT: Breakdown by bank.	*m*	*14*	*CBT*
NPLs: Stock of banking sector NPLs, and breakdown by commercial banks.	*q*	*60*	*CBT*
Balance sheets of commercial banks, including detailed income statements, in accordance with "Uniform Bank Performance Reporting" agreed with Fund staff.	*q*	*60*	*CBT*
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*	*CBT/MoF*
The price structure of the petroleum products and the needed data to monitor the automatic adjustment mechanism (formulas and data).	*d*	*15*	*Min. of Energy*

Supplementary Memorandum of Economic and Financial Policies

Tunis, May 17, 2016

Madam Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, NW
Washington, DC 20431
USA

Madam Managing Director:

1. The information below updates the memorandum of Economic and Financial Policies (MEFP) annexed to our letter dated May 2, 2016 to reflect developments of the past few weeks and our latest commitments on banking reforms (Table 1).

2. **The new legislation on the central bank, bankruptcy and banking statutes was adopted in early May 2016.** These laws will have a large transformational impact on Tunisia's business environment and banking sector, accelerating the modernization of the country's economic structure in a more efficient and equitable way. To ensure the recently approved legislation reduces the remaining gaps with good international practices on banking resolution, we will introduce improvements in the resolution framework by end-August (structural benchmark) through: (i) adoption of a government decree to implement the framework of the Bank Deposit Guarantee Fund that includes a least cost-test for resolution with an exception for systemic cases; and (ii) adoption of a bylaw of the Resolution Committee providing a short timeframe to determine resolution measures for systemic cases.

3. **All three public banks revised their business plans, but two of them need further revisions to ensure regulatory compliance throughout the restructuring period**. The recently appointed management of the STB and BNA public banks initiated their organizational restructuring, but found that more time was needed to revise the business plans in order to fine tune their business strategy and adjust accordingly the new organization and terms of reference of each business unit. To remedy the weaknesses already noted by the Central Bank of Tunisia's banking supervision department, the public banks are working on a new version that will be approved by their boards by end-July 2016 (structural benchmark) and address the following concerns:

- **The plan for STB** will fully incorporate revised macroeconomic and financial assumptions. It will take into account the forthcoming capital requirements on operational risk as well as the lifting of forbearance on new NPLs (granted following the 2015 terrorist attacks) and will focus on a proper NPL resolution strategy rather than on an aggressive growth strategy.

- **The plan for BNA** will focus on maintaining an adequate liquidity and solvency levels throughout the restructuring plan, starting with booking a sale of non-strategic assets as soon as possible to ensure it has enough buffers to continue to meet its capital requirements during the entire restructuring period (2016-20). The plan will take into account the forthcoming lifting of forbearance on new NPLs and the recent government decision on the treatment of new loans to agriculture on a commercial basis (the impact of old loans will gradually fade as these get repaid or resolved, helping profitability). The confirmation of government guarantees (callable on first demand) for loans to public entities will help the bank meet regulatory requirements throughout the restructuring period. Sound operational restructuring will help the bank to properly assess, price, monitor and manage credit risk on all loans.

Table 1. Tunisia: Additional Structural Benchmarks

Proposed Structural Benchmarks	Objective	Date
Financial sector reform		
Approval, by the board of Directors of STB and BNA, of revised business plan ensuring regulatory compliance throughout the restructuring period and in line with the principles detailed in the MEFP.	*Financial sector stability*	Jul-16
Approval of secondary legislation to address some of the weaknesses in the banking law regarding the bank resolution framework through the (i) adoption of a government decree to implement the framework of the Bank Deposit Guarantee Fund that includes a least cost-test for resolution with an exception for systemic cases; and (ii) adoption of a bylaw of the Resolution Committee providing a short timeframe to determine resolution measures for systemic cases.	*Financial sector stability*	Aug-16

Sincerely yours,

/s/ /s/

Chedly Ayari
Governor of the Central Bank of Tunisia

Slim Chaker
Minister of Finance