Report No. 5263-TUN

Tunisia
Financial Sector Report

December 16, 1985

Regional Projects Department
Industrial Development and Finance
Europe, Middle East and North Africa Region

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Document of the World Bank

CURRENCY EQUIVALENT

Currency Unit = Tunisian Dinar (TD)

	1980	1981	1982	1983	1984 (Nov.)
US$ 1 = TD	2.4691	2.0251	1.6929	1.3695	1.2494
TD 1 = $	0.4050	0.4938	0.5907	0.7302	0.8004

List of Abbreviations

AFH	Housing Land Bank
API	Investment Promotion Agency
APIA	Agricultural Investment Promotion Agency
APMANE	Program to assist small farmers in the North-East
BCMA	Banque de la Coopération du Magreb Arabe
BDET	Banque du Développement Economique de Tunisie
BFT	Banque Franco-Tunisienne
BIAT	Banque Internationale Arabe de Tunisie
BNDA	Banque Nationale de Développement Agricole
BNDT/COFIT	Banque Nationale de Développement Touristique/Compagnie Financière du Tourisme
BNT	Banque Nationale de Tunisie
BS	Banque du Sud
BTEI	Banque de Tunisie et des Emirates d'Investissements
BTKD	Banque Tuniso-Koweitienne de Développement
BTQI	Banque Tuniso-Qatari d'Investissements
CAVIS	Old-age, Invalid and Widow Insurance Fund
CCP	Postal Checking Center
CENT	National Savings Fund
CES	Exceptional Solidarity Contribution (20% of TRC)
CLCM	Local Mutual Credit Funds
CNEL	National Housing Savings Fund
CNRPS	National Retirement Fund
CNSS	National Social Security Fund
CPE	Personal Income Tax
ETAP	National Petroleum Company
FBCI	Credit and Investment Subsidy Fund
FNAH	National Fund for Housing Improvement
FNG	National Guarantee Fund
FOPRAM/FNPAPM	Fonds National de Promotion de l'Artisanat et des Petits Métiers
FOPRODI	Industrial Decentralisation Promotion Fund
FOPROLOS	Housing Promotion Fund for Wage Earners
FOSDA	Special Fund for Agricultural Development
FOSEP	Special Fund for Fishery
INS	National Statistics Institute
IRVM	Securities Income Tax
OC	Cereal Office
OMV	Office de Mise en Valeur
ONH	National Oil Office (Olive Oil)
PE	Public Enterprise
SCMA	Agricultural Mutual Guarantee Companies
SICAV	Variable-capital Investment Companies
SME	Small- and Medium-scale Enterprises
SMIG	National Minimum Wage
SNIT	National Building Company
SPROLS	Social Housing Promotion Company
STB	Société Tunisienne de Banque
STEG	Tunisian Electricity and Gas Company
STUSID	Société Tuniso-Séoudienne d'Investissements et de Développement
TPS	Sales Tax
TRC	Tax on Interest on Credit Balances
TTB	Tax on Stock Market Transactions

Abstract

This report analyses the Financial Sector in Tunisia and makes recommendations for strengthening policies and institutions to increase domestic resource mobilization and improve investment allocation. It reviews the efficiency of the banking system, the Government's credit policies, the development of the capital market, and the financing of agriculture, industry, housing, and public sector enterprises. The recent downward trend in the domestic savings rate and the high investment rate led to a resource gap, which, if not reduced in the near future, will lead to unsustainable external debt levels. Specific measures to improve savings are recommended.

Although Tunisia has a well developed financial system, there are constraints on the autonomy of the institutions involved and on the competition among them. Recommendations to address these issues are outlined in Chapter III. Chapter IV recommends the introduction of a system of credit controls which would impose greater discipline on the expansion of credit by the banking system. An active interest rate policy would form an integral part of the overall credit policy. The introduction of liberalization measures to improve the efficiency of the financial sector are discussed in Chapter V. Chapters VI to IX give a detailed analysis of the financing of the agricultural, industrial, housing and public enterprise sectors.

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This report is based on the work done by a sectoral mission that visited Tunisia from May 20 to June 8, 1984. The members of the mission were Messrs. J. da Silva Lopes (Chief, Consultant), B. Pottker (Assistant Chief), Mr. Farsad (Economist), C. de Boissieu (Consultant), Buu Hoan (IMF), S. Rothman (IMF) and S. Haddad (IFC). Messrs. J.F. Landeau and J.P. Chausse also assisted with the writing of the report. The report has been updated on the basis of the discussions with the Tunisian authorities in April 1985.

INTRODUCTION

General Background

1. This report is an important contribution to the overall economic and sector work program of the Bank currently underway, which includes among others: a review of the Tunisian Five-Year Plan (1982-1986), a report on Industrial Employment, an Industrial Policy Report and several sector studies covering agriculture, housing and transport. It was prepared at the request of the Tunisian Government in order to respond to three major concerns: the domestic resource gap, the adequacy and efficiency of the financial-institutional framework and the effectiveness of existing credit policies for the main economic sectors.

2. Tunisia's economic and financial system is to a considerable extent a managed system, where market forces are allowed to play only a limited role. Prices (including wages and interest rates), investments, imports, foreign exchange and credit are all regulated and controlled by a sometimes heavy bureaucratic machinery. While this system functioned with a reasonable degree of success during the seventies, when foreign exchange resources were relatively abundant, it has functioned less effectively and efficiently in the past three years. Foreign exchange constraints and external disequilibria have in this period accentuated the internal disequilibria created by this excess of controls and regulations.

3. The financial sector is as much regulated as the other sectors of the economy. A multitude of administered interest rates has resulted in a confusing pattern of incentives and disincentives. These rates, the level and structure of which was established at a time when the Government was the largest saver and investor, do not particularly encourage private savings (except for special saving schemes for housing, the setting up of a small business and to encourage deposits of foreign workers); they have lost most of their function of allocating funds to potential investors on the basis of efficiency. Almost all credits to the economy, except credits to the Government, need prior approval by the Central Bank which decides on a case by case basis or are provided on the basis of approval by other Government agencies (API for investments, Ministry of National Economy for imports). The financial institutions, working in a system of fixed margins (which are relatively small in comparison with other countries) cannot afford to take risks and have scaled down their financial services. All these factors have led to a fragmentation of financial markets, created inter-sectoral distortions, with a less than optimal allocation of credit, and favored public over private investments. Finally the Central Bank pursued an extremely accommodating overall credit expansion leading to inflation and balance of payment pressure.

4. While the Tunisian authorities have become aware of the deficiencies of this managed system, they are sensitive to the risks of relaxing controls in an abrupt fashion given the present internal and external economic and

financial disequilibria. They agree that relaxation of controls and a greater reliance on the market mechanisms would enhance the efficiency of the economy. However, they fear that a rapid relaxation of these controls would, in the short run, accentuate the existing imbalances.

5. Against the above background, this report proposes a gradual transition towards a more liberalized system. It recommends a series of coherent actions which would give greater room for the market to play its role, would replace à priori authorizations by ex-post controls, would introduce a greater degree of flexibility and would provide more autonomy and responsibility to the financial institutions, all within a clear set of objectives and targets. For some time the financial system would remain a managed one but these recommendations would set the country on the road to further relaxation of controls as and when the increased efficiency of the economy, particularly in the productive sectors, would improve Tunisia's competitive position and balance of payments. For maximum impact, greater financial liberalization would have to go hand in hand with greater relaxation of price, investment and trade policies.

Macro-Economic Aspects

6. The Tunisian economy expanded very rapidly during the Fourth and Fifth Development Plan periods (1972-81), recording average annual GDP growth of 7.5%. During recent years, however, substantial difficulties have begun to appear. GDP growth has fallen to 3.3% during 1982-84. The average inflation rate (measured by the consumer price index) rose from 7.8% in 1976-81 to 10.5% in 1982-1984. The balance of payments deficit has remained high, reaching 10.4% of GDP in 1984, in spite of the slackening of economic growth.

8. The outlook for the coming years is not very favorable. The good performance during the 1970s was explained in large part by the expanded oil production and improved terms of trade consequent on the rise in world oil prices. In contrast, the current projections indicate that volume of oil exports will tend to fall and no substantial improvements are foreseen in Tunisia's terms of trade. The Tunisian authorities therefore face considerable challenges in gradually raising the level of living of the population, absorbing unemployment, reducing the balance of payments current account deficit and bringing inflation under control.

9. Pursuit of these in part conflicting objectives will call for coordinated application of a wide range of economic policy measures. Among these, the proposed reform of the financial system could play an important role. The object of the present report is to study the potential contribution of these changes to improving economic growth and reducing domestic and external disequilibria. Improving economic growth will call for a higher domestic savings rate and more efficient allocation of financial resources among alternative uses. Reducing domestic and external disequilibria will call for tighter control of total domestic credit. The purposes of the measures for improving the financial system can therefore be grouped into three broad categories: (1) increasing domestic savings; (2) tighter credit control, and (3) more efficient allocation of financial resources.

Increasing domestic savings

10. During the last few years domestic resources have financed about one-third of investment. The balance of payments deficit was 9.4% of GDP in 1982, 8.8% in 1983, and 10.4% in 1984. If the resource gap remains so wide in the years ahead, external debt will rapidly rise to intolerable levels. If the recent downward trend in the domestic savings rate is not halted and even reversed, the Tunisian authorities will be compelled to reduce the investment rate so severely as to have adverse consequences for future economic growth.

11. The difficulties in the way of improving savings are examined in Chapters I and II of the report. Chapter I analyzes the trend of domestic savings structure and the resource gap problem against the general background of recent economic developments. Chapter II examines the problem of improving public saving and possible financial measures to stimulate household saving. It also highlights the need to halt the downward trend of public saving by improving the taxation system and, in particular, stricter control of current budget expenditure. It also recommends a number of measures to stimulate financial savings of households. These include raising the interest rates on savings accounts and time deposits, and changes in compulsory placement ratios and other regulatory requirements imposed on the financial institutions that make time deposits and savings accounts less attractive than demand deposits.

Stricter control of credit

12. During the period 1980-83 total domestic credit of the financial system (including the development banks) rose on average by 23% a year while the money supply expanded on average by 18%. Since the velocity of income circulation of money has declined very little, the rapidity of monetary growth has been a factor in inflation and in balance of payments pressure. There are currently no general target levels for money or credit. Control of the money supply is based essentially on limits on Central Bank refinancing of the development banks. Chapter IV recommends the introduction of a system of capping of domestic credit as a method of controlling monetary growth. It is felt that such a system would allow the monetary policy authorities to assess more clearly the impact of their credit decisions on the money supply (and consequently on inflation) and on the balance of payments. It would also allow the authorities to tune these decisions more finely. Chapter IV also proposes other changes in overall credit policy, particularly with regard to raising the compulsory reserve ratios, refinancing of the banks, and lending interest rates policy.

Improving the efficiency of resource allocation

13. One of the basic functions of the financial sector is to channel the funds it obtains from savers toward the utilizations that will contribute most to the development and equilibrium of the economy. In Tunisia the financial sector is prevented from performing this function with satisfactory efficiency by (i) the very far-reaching official intervention in credit operations; (ii) the very sharp disparities in the operating conditions of the various financial institutions, and (iii) the inadequate development of the capital market.

14. The authorities intervene in credit operations not only through overall control of money supply volume and general regulation of the financial system but also through the distribution of total credit among the various categories of operations and the specific conditions prescribed for some of them. This intervention is applied through an array of instruments: a very detailed and very complex lending rates grid, with substantial variations between different types of operations; the requirement of prior approval by the Central Bank, which applies to a high proportion of bank loans; compulsory ratios of placement of bank resources in capital equipment bonds issued by the Treasury and in medium-term loans; the interest rate subsidies and subsidized loans granted by the various government funds in favor of lending to certain sectors; the assumption by the Government of the exchange risk in loans obtained abroad by certain institutions; the allocation of resources to certain specialized institutions and the particularly favorable loan terms applied by them, and so on.

15. The problems created by all these forms of intervention are examined in Chapters IV through X of this report. Those chapters cover general credit policy, selective credit policies, and the special credit policies followed in the agriculture, industry, export, housing and public enterprise sectors. The government interventions examined in those chapters substantially distort the allocation of financial resources, by fragmenting the market and causing inequalities in the terms of credit access by the various sectors. It is true that official intervention in financial operations can be justified by discrepancies between social prices and costs and market prices and costs. But these discrepancies are very commonly traceable to the effects of government intervention on other sectors of economic activity.

16. It can be concluded from the foregoing comments that improving the resource-allocation efficiency of the financial system calls for the introduction of far-reaching liberalization measures, i.e. a substantial scaling down of government intervention in credit operations. However, sizable financial liberalization would be practicable only as an integral part of a general trend of liberalization of economic activity as a whole. Advancement toward substantial financial liberalization would therefore be difficult unless the authorities took the policy decision to introduce radical changes in the general orientation of economic policy. However, if such a decision could not be taken, it would at least be possible to take a gradual approach, introducing partial changes, with the object of eliminating or reducing some of the major constraints and distortions imposed by government interventions that currently impair the efficiency of the financial system. The recommendations put forward in the present report are geared to this step-by-step approach. The recommendations must therefore be regarded as a first step, to be supplemented by further financial liberalization measures during subsequent stages.

17. Among partial liberalization measures to be taken during the first phase, it is recommended that the authorities abolish the requirement of prior authorization by the Central Bank, which applies to a high proportion of bank loans, and widen the ranges of variation of lending interest rates and bank commissions fixed by the authorities. It is also recommended that, to reduce

the distortions caused by the regulatory measures and interventions not abolished, they should introduce a number of adjustment measures, including the following: greater flexibility in the interest rates set by the authorities; narrowing of the disparities between the more highly and the less highly subsidized interest rates; creating the conditions for more equitable competition in medium-term lending between the deposit banks and the development banks; setting up mechanisms for stricter control of budget expenditure on subsidies to certain types of loans and better coordination between the conditions of granting of such loans. The general purpose of these recommendations and others of the same type put forward in the report is to reduce the fragmentation of the financial market, increase competition on that market, improve the conditions of granting of loans, and reduce budget expenditure on subsidized loans.

18. The efficiency of credit resource allocation depends not only on greater financial liberalization and correction of the distortions caused by government intervention and regulation. It depends also on the institutional structure and operational capacity of the financial system. Although Tunisia has a well developed financial system, there are problems with respect to competition among the various types of existing institutions, raising of the necessary resources to fund the operation of the development banks, and creation of new specialized institutions. These problems are examined in Chapter III. Recommendations are offered in that chapter with the object of: (i) promoting greater competition between the various types of financial institutions; (ii) establishing more equitable conditions of mobilization of resources by the development banks; (iii) the exercise of prudence in the creation of new financial institutions, particularly specialized institutions, which could aggravate the fragmentation of the financial market and raise bank intermediation costs.

19. Finally, an important component of the policy of improvement of the efficiency of the financial system is development of the capital market. In Tunisia, as in most developing countries, the capital market is not very active. Development of this market could help improve the financial structure of the enterprises by enabling them to raise more stable resources. Against this background, Chapter X presents an analysis of the regulatory, institutional and fiscal measures that could stimulate development of the capital market.

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

I. Domestic Financial Resources and Economic Development

1. During the period of the Fifth Economic and Social Development Plan the Tunisian economy underwent rapid expansion based on an improvement in the terms of trade, due mainly to the rise in oil prices. However, average annual GDP growth fell, from 6.3% in 1977-81 to 3.3% in 1982-84, owing to the effects of the drought on agricultural production and the unfavorable trend of the international oil market. During recent years the domestic and external imbalances have worsened severely. The Administration budget deficit reached 6.7% of GDP in 1983 and 7.6% in 1984. Finally, the sharp pressure of domestic demand pushed inflation to about 9% in 1983 and 1984 in spite of tightened price control.

2. Consumption has increased in real terms faster than GDP in recent years, reducing the domestic savings rate from 24% of GDP in 1980 and 1981 to around 20% in 1983 and 1984. The rate of household saving is estimated to have improved, increasing from 7.8% of GDP in 1981 to 9.2% in 1984, but not sufficiently to offset the declines in government saving, from 9.8% of GDP in 1981 to 8.6% in 1984, and in public enterprise saving, from 7.0% in 1981 to 2.9% in 1983.

3. The investment rate has remained high, of the order of 30% of GDP, in spite of the unfavorable economic situation in recent years. Because of the decline in savings this has resulted in a shortage of investment resources and necessitated increased recourse to direct foreign investment (which financed about 13% of total capital formation) and foreign loans. As a result, the external debt burden has risen sharply and will exceed 50% of GDP in 1985.

4. In the next few years Tunisia cannot continue to rely on an inflow of foreign resources similar to that of recent years. Moreover, it will not be easy to increase the rate of domestic savings, particularly government savings, to any considerable extent in view of the downward trend of oil receipts. In these circumstances, to avoid a rapid build-up of external debt Tunisia will need to contain the growth of total demand, to stimulate exports of manufactures and to reduce sharply the rate of fixed investment. The Tunisian authorities have already been looking into measures for better controlling capital expenditure. Their goal is to reduce the investment rate to approximately 25% of GDP over the next few years. To alleviate the adverse effect of the reduction in the investment rate on the growth of national product it will have to try to improve the incremental capital/output ratio (ICOR), which rose from 2.7 during the Fourth Plan to around 12 during the last three years of the current Sixth Plan. On the basis of reasonable hypotheses concerning the ICOR, and with real growth rates of 3-4% for GDP and 5-6% for savings during the second half of the present decade, nearly 70% of investment could be financed by domestic savings six years from now. The external debt burden would then be held at a tolerable level (below 50% of GDP) and the debt service ratio would not be much higher than 20%.

II. Public Savings Mobilization

5. The rate of public saving (excluding the public enterprises), calculated using the methodology of the IMF's Government Financial Statistics (which gives lower rates than the national accounting method but shows the same trend in recent years), has fallen from 9.2% of GDP in 1980 to 4.8% in 1984. This deterioration in public saving is due mainly to the unfavorable trend in expenditure.

6. Oil receipts, which had risen to 6.4% of GDP in 1982, fell back to 5% in 1984. Income and profits taxes have consistently represented a very low percentage of GDP, usually less than 5%. While total budget receipts have increased from 31.4% of GDP in 1980 to 35.5% in 1984, the outlook for the years ahead is not very encouraging: oil receipts are expected to continue to fall and Tunisia cannot count on an increase in import duties similar to that of recent years.

7. In spite of the small potential increase in receipts, current expenditure of the Government rose from 22.2% of GDP in 1980 to 30.5% in 1984, as a consequence of particularly sharp rises in wages, public-debt interest and, above all, consumer subsidies and transfers to households and enterprises, which together reached 13% of GDP in 1984 (10% in 1981).

8. With the aim of correcting the trends indicated by the projections and maintaining the level of public savings, the authorities should seek to increase non-oil tax revenue and should step up their efforts to tighten control of the growth of current expenditure.

9. In the fiscal area, substantial gains, particularly in equity and efficiency, will be obtainable through the tax reform, which is aimed at simplifying taxes, lowering certain rates considered to be too high, and progressively widening the scope of the value added tax. The Tunisian authorities have already introduced a number of measures oriented toward these goals. Gradual advances are now being made toward combating tax evasion. The domestic prices of certain oil products, which were below the prices in effect in many other countries, have recently been raised. However, tax revenue requirements could necessitate new increases in those prices in the future.

10. Nevertheless, in view of the already high tax burden -- about 30% of GDP, not counting oil receipts -- the Government's action to avoid a decline in the rate of public saving should focus mainly on control of current expenditure. This control should be directed essentially to wage expenditures and transfers to consumers and public enterprises. The 1985 budget already reflects major efforts to contain expenditures on subsidies and civil servant wages. The recommendations contained in Chapters V and IX concerning interest rate subsidies could help to reduce budget expenditure on current transfers.

III. Household Savings

11. About 40% of household savings is placed in financial assets, a very high proportion of which is accounted for by currency and time deposits. The gradual increase in the M2/GDP ratio from 39.8% in 1977 to 43.5% in 1984 consequently gives a good picture of the trend of financial saving. The share

of bank deposits in the total money supply has risen gradually, from 70% in 1967 and 75.6% in 1975 to 78.1% in 1983, which is in line with the normal trend in medium-income countries like Tunisia.

12. The amount of time deposits has declined during recent years, mainly as a result of the fall in deposits of insurance companies and social security funds. The share of time deposits in total deposits of households has also fallen, while the share of special savings accounts has risen substantially, as a consequence of the tax exemption they enjoy, their liquidity and their interest rate (which is quite attractive in comparison with other forms of saving and which in real terms has probably shifted into the slightly positive range, following the recent increases for accounts with a term of longer than two years).

13. A not inconsiderable share of the monetary components of saving consists of deposits by Tunisian workers abroad. The banking system offers such workers foreign exchange savings accounts and convertible dinar accounts that pay interest higher than the special savings accounts and exempt from tax. However, it has to be recognized that the introduction of new savings instruments for Tunisian workers abroad has so far proved to be of limited effectiveness.

14. Lending and borrowing interest rates are closely managed. The general thrust of the proposed interest rate policy is set forth in paragraph 37 below. In April 1985 the Tunisian authorities introduced interest rate increases that were partially in line with the Bank mission's recommendations. However, many of the borrowing rates are still negative in real terms after taxes, despite recent increases. It would be desirable to increase them a little more for placements in excess of six months. To stimulate financial savings by households, consideration should thus be given (except in the highly unlikely case of a rapid and substantial drop in the inflation rate) to the following adjustments to the borrowing rates:

(i) The interest rates on time deposits and certificates of deposit (bons de caisse) with maturities of up to 2 years (whether registered or to bearer) should be increased by 2 points. The real after-tax yield on time deposits of 1 year to 18 months would be about 8.6% and would thus remain slightly positive, assuming that inflation is held at around 8%;

(ii) The interest rates on time deposits and certificates at 2 years or longer (which at present account for about one-half of time deposits) should be deregulated;

(iii) The interest rates on special savings accounts should be increased by 1.5 points; the spread between the yields of time deposits and special savings accounts at more than 2 years would be narrowed from 1 point to about 0.5 of a point;

(iv) The interest rates on demand deposits should be kept at their present levels, i.e. 1% for deposits of enterprises and 2% for those of individuals;

(v) The interest rate on convertible dinar deposits of Tunisian workers abroad should remain at the present level of 10.5%;

(vi) The interest rates on savings accounts in foreign exchange should match the interest rates on deposits with similar characteristics and in the same foreign currencies in other countries; they should be changed fairly frequently (for example, every three months) to reflect changes in the interest rates of each currency;

(vii) The interest rates payable should be made more flexible. To this end, the interest on time deposits and certificates at less than 2 years and on special savings accounts should be tied to a base rate.

15. The proposed increase in borrowing rates should be accompanied by similar increases in bond interest rates. It would help to raise the share of financial savings in total savings and the proportion of household savings mobilized by the financial intermediaries. This would make it possible to reduce the nonproductive direct investment of informal savings (certain real-estate assets or durable goods) and to raise the overall efficiency of investment. Moreover, the rise in interest rates payable would help, at least in part, to slow down capital outflows and to discourage the nonrepatriation of export earnings, which has been taking place in spite of exchange control.

16. Since the resource structure of the deposit banks includes a high proportion of demand deposits, the recommended increases in interest rates payable would cause an increase in average cost which, even after two or three years, would not exceed 1 point.

17. The following action would be necessary to make time deposits and special savings accounts more attractive to the banks:

(i) There would be three levels of cash reserves, the increase of which is proposed in paragraph 33: a rate for demand deposits; a second, lower rate for special savings accounts and time deposits of up to 12 months; and a third, even lower rate (which might even be zero) for time deposits and special savings accounts of more than 12 months and deposits of Tunisian workers abroad regardless of term.

(ii) The ratio of compulsory placement in capital equipment bonds and CNEL bonds should be differentiated in accordance with a formula similar to that proposed in (i) for the cash reserve ratio;

(iii) The ceilings for credit expansion proposed in Chapter III should be determined in light of the growth in the deposits of each bank with different weights assigned to each type of deposit, e.g. 1 for demand deposits and time deposits up to 12 months, 1.5 for time accounts of over 12 months, and 2 for deposits of Tunisian workers abroad. Equity funds would receive a weighting of 3.

18. The authorities have introduced new "financial instruments" and are granting significant tax advantages to stimulate household savings. Three new financial instruments have been introduced since 1982: employment savings accounts, for accumulation of the self-financing required for the execution of small projects; project savings accounts, whose purpose is to build up the funds required to finance projects approved or eligible for assistance by FNPAPM, API or APIA; and investment savings accounts, for the acquisition of

securities of approved companies. The introduction of study savings accounts is also contemplated. All these formulas enjoy substantial tax advantages.

19. It is still too early to assess the impact of these new financial instruments. However, it would seem undesirable to go any further in this direction, for three reasons: (i) the proliferation of earmarked savings schemes would fragment the financial system and reduce its efficiency; (ii) it is necessary to limit the cost to the State budget of the tax advantages accorded to earmarked savings accounts; and (iii) the advantages accorded to such accounts frequently accrue largely to individuals with medium and high incomes. The authorities should therefore avoid the proliferation of new savings formulas. They could, however, consider the introduction, after thorough study, of a financial instrument -- to be offered by CENT and, if they were interested, also by the deposit banks -- which would be reserved in principle to individuals with taxable incomes below a certain threshold.

20. The Tunisian banks have shown substantial dynamism in the mobilization of household financial savings in spite of their minimum balance requirements for the opening of deposit accounts. The number of bank offices per capita is higher than in other countries of comparable development, though there are still signs of inadequate bank infrastructure and a high concentration of bank offices in the best-served areas. The current regulations require that any bank program for the opening of five or more branches must provide for at least one outlet in localities that totally lack banking facilities. This requirement should be supplemented by incentives to open offices in the poorly served areas, for example in the form of temporary tax advantages (in particular, accelerated investment depreciation).

IV. Financial Institutions

21. Tunisia has a well-developed financial system comprising, in addition to the Central Bank, ten deposit banks, nine development banks, two specialized savings institutions, a network of postal checking offices, six portfolio management agencies, seven offshore banks, a leasing company, offices representing foreign banks and the stock exchange.

22. The development banks are in a distinctly less favorable situation than the deposit banks with respect to the mobilization of resources, since their ability to receive deposits and their use of Central Bank refinancing are closely limited. The resources of the development banks comprise special government loans earmarked for certain specific types of credits, loans obtained abroad, and their own capital. The BDET and, recently, STUSID have also obtained resources through the issuance of bonds, though in modest amounts. The new development banks have expanded their operations considerably during recent years by using their own very large capital, but in the future they would need to tap other financial resources.

23. Consideration should be given to the following measures to increase the mobilization of resources for the development banks:

(a) Government loans: If the Government gives up responsibility for part of the financing of the public enterprises and if that responsibility is transferred to the development banks, part of the corresponding financial resources, currently used by the State, should also be transferred to them. This would mean that part of the proceeds of the issues of capital equipment bonds (bons d'équipement) the deposit banks are required to subscribe would be transferred directly or indirectly to the development banks.

(b) Refinancing by the Central Bank: To ensure more equitable distribution of Central Bank resources between deposit banks and development banks, and to reduce the average cost of the development banks' resources, the authorities should consider establishing better facilities for rediscounting medium-term credits in favor of the development banks. This would not necessarily mean undesirable increases in the money supply if compensatory adjustments were made in other rediscounting categories or in the money market.

(c) Issuance of bonds: The absorptive capacity of the Tunisian financial market is limited, but it could be developed if more interesting financial products were offered. The development banks could contribute to the market's development by issuing bonds on terms likely to attract subscribers.

(d) Increase in equity capital: If the development banks proved sufficiently profitable in the next few years they could raise equity funds by offering shares for public subscription or seeking additional contributions from foreign partners.

24. The new development banks will undoubtedly be able to obtain foreign loans without needing the Government's guarantee. That guarantee should be given only in cases where the interest rate difference between guaranteed and non-guaranteed loans is very large. It has to be borne in mind that once the first government guarantee has been given for a private international loan, all international creditors will ask for similar guarantees.

25. The system of coverage of exchange risks should be based on payment by the beneficiaries of commissions, which would differ according to the currencies involved in each loan. The cost of the foreign resources would be uniform after payment of these commissions, and the borrowers would have no reason, as they have at present, to prefer loans in strong currencies, with lower interest rates but higher appreciation risks.

26. The average cost of commercial bank resources is considerably lower than that of development bank resources (difference of 3 to 5 percentage points). With the object of establishing more equitable conditions of competition between the deposit banks and the development banks, the present de facto nonregulation of interest rates on long-term credits should be maintained and the recommendation made in paragraph 23 above should be implemented so as to reduce the cost differences between the resources used by development banks and those used by deposit banks to finance medium-term loans, particularly to the SMEs.

27. The intermediation spreads of the Tunisian deposit banks are lower than those found in many developing countries and lower even than those of a number of small and medium-sized developed countries. BDET's intermediation costs are also lower than those of the development banks of many other countries. This situation is probably explained by the discipline imposed by the Central Bank and by the regulation of the spreads between lending and

borrowing rates. Since the Tunisian market is very small, the comparatively small intermediation spread suggests that economies of scale have not been an important factor in the efficiency of the Tunisian banking system. However, in spite of all the uncertainties it appears that the creation of new banks would not do much to improve the efficiency of the Tunisian banking system.

28. There is some specialization in the Tunisian banking system. While this has advantages, it also involves risks. Experience in Tunisia shows that the specialized institutions are too vulnerable to the difficulties of their specific sectors and consequently often seek to diversify their operations. Moreover, excessive specialization could reduce competition among the banks, to the detriment of investors. In the present context, therefore, increased specialization by banks should be avoided.

29. The number of financial institutions operating in the Tunisian market is already quite high for its small size. Nevertheless, the question is often raised of establishing new ones. The creation of new institutions should be agreed to only in the following cases: (i) the conversion of existing institutions, such as the creation of a National Postal Bank to replace the National Savings Fund (CEN) and the Postal Checking Center (CCP) and the conversion of CNEL into a Housing Bank; (ii) the creation of institutions with specialized functions that are lacking in Tunisia, such as leasing companies; and (iii) the creation of institutions that bring in substantial amounts of foreign capital (though in these cases it would be preferable to encourage the promoters to look to acquiring or strengthening one of the existing banks rather than setting up a new bank). The creation should be avoided of a national foreign trade bank, of regional banks and of a bank for workers abroad. The establishment of a bank for local governments should also be rejected. Consideration should however be given to a housing bank to replace the CNEL.

30. There are at present seven foreign banks with agencies or offshore activities in Tunisia but their operations are very limited. Foreign banks have shown considerably less interest over the past few years in establishing offshore banks in Tunisia. To revive their interest, and also for balance of payments reasons and to dynamize Tunisia's banking system, the authorities are thinking of considerably expanding the field of action of the offshore banks in the area of foreign exchange operations. In defining a system offering sufficiently attractive advantages to the offshore banks, and at the same time respecting the conditions of well-balanced competition with the local banks, the authorities are faced with the need to decide very carefully among a number of awkward and difficult choices, as they are indeed well aware.

V. Credit Policy

31. Credit expanded in nominal terms at an annual rate of around 22% in 1980-84. The pressure imposed by the expansionary monetary policy on consumer prices and the balance of payments has been contained in part by a tightening of price controls and of the import licensing system. Such measures may mitigate the internal and external imbalances temporarily, but they cannot provide a lasting cure for these disequilibria.

32. At present the authorities are announcing no explicit overall targets for money and credit. To curb inflation and the balance of payments deficit,

it would be well for the authorities to institute a system of credit control, setting annual ceilings for the expansion of credit by each bank. The ceiling would be based on the amount of the bank's resources during the previous year (or six-month period), with higher rates for equity funds, deposits of Tunisian workers abroad, time deposits and savings accounts than for demand deposits (see para. 17). Some preferential credits such as seasonal farm loans and short-term export credits could be exempted from the ceilings.

33. For better management of the monetary base, so that its expansion will be compatible with credit control, the cash reserve requirement (zero at present) should be raised, with a higher percentage for demand deposits than for time deposits and savings accounts (see para. 17).

34. The introduction of credit ceilings would make it possible to eliminate direct regulation of the volume of refinancing by the Central Bank, which is based on a ceiling that can be as high as 17.5% of deposits and is calculated on the total amount refinanced by each bank. By placing a ceiling on a given commercial bank's credit to the economy, the Central Bank would indirectly be setting a limit on that bank's refinancing requirements. Furthermore, raising the percentage of required cash reserves as proposed in para. 33 would necessitate an increase in refinancing extended by the Central Bank to deposit banks, to enable them to maintain the same level of total credit.

35. With the introduction of credit controls and an increase in the percentage of required cash reserves, the role of refinancing as an instrument for managing the money supply and the overall volume of credit would become less significant. Rediscounting should be confined to preferential lending, which is by and large the present situation; nonpreferential credits account for only a rather limited quota (about 10%) of the total amount rediscounted. The additional liquidity that the development banks would need to finance nonpreferential lending under their credit ceilings would have to come from the money market.

36. Matching of the total level of credit, as determined under the system of credit ceilings, with the monetary base would be done through the money market. If the volume of transactions on that market were to reach too high a level and remain there, the authorities could consider other adjustment measures:

(i) Raising the percentage of required cash reserves in cases of persistent excess liquidity, and lowering the percentage in the opposite cases;

(ii) Reducing rediscounts in cases of excess liquidity, by excluding certain types of credit from the category of rediscountable preferential credit, or by lowering the proportion of each credit that can be rediscounted (e.g., from 80% to 60%), or by establishing rediscount ceilings for each bank. The first two of these alternatives would be preferable to the last.

37. The rise in the average cost of resources due to the increase in borrowing rates as proposed in para. 14 should be reflected exactly in lending rates, to avoid a significant narrowing of the interest rate spreads of Tunisian banks. These rates were in fact increased in April 1985, which

represented a major step forward toward implementing the recommendations formulated in 1984 by the Bank mission that prepared this report. Additional increases in the lending rates of 0.5 to 1 point might also be necessary to match the increases in the borrowing rates recommended in para. 14. Over the longer run, the interest rate system should be liberalized. In the short term, however, if the authorities were to attempt to control the volume of money supply, the sudden freeing of interest rates might well lead to either agreements among the banks to limit competition or excessive increases in real interest rates, which could cause grave difficulties for industrial enterprises and for the banking system. In cases where credit supply and demand are rigid, slight changes in supply or demand can give rise to large fluctuations in interest rates. Experience in several developing countries that have tried to impose strict controls on money supply shows that interest rates rose excessively. In order to avoid these risks, the deregulation of interest rates should be introduced gradually. In the initial phase, the policy to be followed should be based on the following: (i) raising of the existing level of interest rates; (ii) introduction of greater flexibility in the average level of interest rates; (iii) establishment of wider spreads for permitted variations in certain lending rates; and (iv) deregulation of certain interest rates.

38. With the proposed increase in lending rates the real cost of credit would still be very low. The rise in the total costs of firms would not exceed 0.2%.

39. To alleviate the impact of the rise in interest rates on borrowers, the Tunisian authorities should consider a modest reduction -- from 8.69% to 6% -- in the TPS on interest paid. The resulting decrease in State tax revenue would be small, inasmuch as the taxable base would expand (because of the increase in interest rates and the normal tendency for the volume of credit to rise). Although the TPS is an easy tax to collect, it has adverse effects on investment, financial intermediation and savings. For that reason, it would be preferable to develop other sources of tax revenue.

40. It should be possible for changes in interest rates to be made with greater flexibility than at present. To this end, the adoption might be considered of a system (already used in part) whereby all lending and borrowing rates of interest would be related to a base rate. Under such a system changes in the base rate would automatically result in changes in borrowing and lending interest rates. Adjustments in the level of interest rates to changes in inflation and in other indicators would therefore become easier and more automatic.

41. Furthermore, the range of authorized spreads for lending rates would have to be broadened, from 1 to 1.5 percentage points depending on the type of credit. Likewise, bank commissions would be fixed systematically in the form of spreads (commissions already fixed in that form would have a wider range). The enlargement of authorized spreads would help to strengthen competition among banks through interest rates, and to adjust effective lending rates to the client risk.

42. Interest rates on long-term lending should remain unregulated as at present. It should be possible to adjust them periodically, as is now done

for medium-term loans made by deposit banks. Such adjustment of interest rates on long-term loans seem necessary to protect the banks against the risk of excessive losses which could result from a rise in the average cost of their resources.

VI. Selective Credit Policies

43. The selective credit policies followed in Tunisia have contributed to the increase in the proportion of medium-term credit allotted to types of financing which, under normal conditions, would not be of sufficient interest to deposit banks (agriculture, small and medium-scale enterprise, housing, investment in less developed regions, etc.). Nonetheless, it has certain negative aspects: (i) the system is complicated; (ii) it fragments the financial market and causes a less than optimum allocation of available resources; (iii) it is very costly for the State, which cannot continue to bear the mounting burden it represents for the medium term; (iv) the advantages of selective credit are not distributed equitably among all firms, and often go to the largest and best organized; (v) the policy of selective credit results in excessive disparities between the costs of different types of credit (ranging from 3% to 14%); (vi) the low cost of subsidized credit induces an artificial increase in demand, and this makes it necessary to impose rationing and administrative controls to avoid the diversion of preferential credit to other uses; and (vii) subsidized interest rates discourage infusions of equity capital and foster the adoption of highly capital-intensive production methods.

44. The following measures should be considered to offset the impact of the negative factors just mentioned:

(a) Change in rediscounting policy. If the system of credit controls proposed in paras. 32 through 36 is introduced, only preferential credit should be allowed access to rediscounting by the Central Bank at fixed rates. In principle, it would not be necessary to establish rediscount ceilings for selective credits. If, however, the expansion of the monetary base has not been commensurate with total credit expansion, it might be necessary to impose restrictions on the total rediscounted amount of selective credits. In such a case lowering the percentage of the amount of each type of rediscountable credit would be preferable to imposing ceilings on certain categories of credit. It would probably suffice to have only two or three rediscount rates: one for export credits, possibly one for seasonal agricultural loans, and another for medium-term loans. Development banks should also be able to rediscount some of their medium-term loans (which might mean that the Central Bank would have to curtail some of its other refinancing operations, so as to keep tight control over expansion of the money supply).

(b) Adjustment of the level of preferential interest rates. The difference between the rate with the largest subsidy and the highest nonsubsidized rate should not be more than 7 points. Some preferential rates which are currently 3% or 4% should be raised to at least 7% or 8%. The liquidity problems caused by a rise in nominal rates should be solved through the introduction of grace periods, longer amortization schedules, and even — if necessary — total or partial capitalization of interest for an initial period.

(c) Change in the ratio of private medium-term credits. Since the establishment of new development banks the ratio of private medium-term credits required of the commercial banks has become less necessary. It seems preferable to promote the involvement of deposit banks in the financing of investment through incentives rather than through the requirement of a high percentage of medium-term credits. This being the case, an initial phase might call for a decrease in the proportion of medium-term private credits from its present 18% to 15%. Also proposed is the gradual introduction, within the ratio of medium term private credits, of a "subratio" of 7% for medium-term credit to SMEs and to small and medium-scale farmers, incorporating the existing 2% subratio for credits to artisans and small skilled tradesmen. If lowering the requirement of such credits from 18% to 15% has no negative effect, further reductions could be made in the future. Ultimately one might envisage a ratio of 7%, which would apply solely to credit to SMEs.

(d) Modification of the system of subsidies for preferential credit. The system for subsidizing interest rates on preferential credit for capital investment projects should be revised. The recipients of such credit should receive the interest rate subsidies directly from their banks, regardless of whether the loans are rediscounted with the Central Bank. This would forestall the danger of excessive pressure from selective credit on the expansion of the monetary base. All interest subsidies -- including those granted at present by FOPRODI, FOSDA, etc. -- should be distributed by a single agency. With this in mind, a Credit and Investment Subsidy Fund (FBCI - Fonds de Bonification de Crédits et d'Investissement) could be set up within the Treasury, financed by appropriations in the State budget. The government agencies with particular responsibility for sectoral policies (API, FOSDA, APIA, FOPRODI, etc.) would give their opinion on the projects to be subsidized or on the criteria for granting them; however, financial management itself would be concentrated in the proposed fund. This course of action would make it possible to: (i) calculate and control more strictly the cost of the policy of subsidizing interest rates and investments, and (ii) make the interest rate subsidy policy subject to overall criteria rather than to sectoral and partial criteria, which often are not sufficiently coordinated, as is the case at present. The Treasury and the various State funds should not make loans to enterprises, either as reimbursable advances or in any other form.

VII. Financing of the Agricultural Sector

45. The Sixth Plan calls for an increase in capital investment in agriculture, which is considered to be a priority sector, from 12.9% of total investment in 1977-81 to 18.9% in 1982-86. Public investment (government and public enterprises) will account for about two-thirds of investment in the sector. Through FOSDA, the State is helping to finance more than two-thirds of private investment, but the role of bank credit in the financing of such investment is expected to become more important in the future.

46. In addition to the adverse effects of selective credit in general, the agricultural credit policy gives rise to a number of specific problems, including the following:

(a) The high cost of subsidies. The cost of interest and other subsidies of FOSDA in 1982 can be estimated at some TD 16 million. To this must be added the State's assumption of the risk of nonrepayment of loans guaranteed by it or financed from budget funds, the cost of covering the foreign exchange risk in loans financed by external resources, the subsidy margins in the rediscounting of agricultural credit at a preferential rate by the Central Bank, and the costs of management and nonrepayment of loans made by the Offices de Mise en Valeur. A priority objective of the change in the agricultural credit system should therefore be to reduce its heavy burden on the State budget.

(b) The proliferation of agricultural credit programs. In the last ten years more than 20 credit programs have been launched for farmers. Such a proliferation fragments the agricultural credit market, causes a less than optimum utilization of available resources, increases the number of middlemen, diminishes responsibility and makes it difficult to monitor and manage the various sources of financing. The diversity of existing programs demands a large administrative apparatus, which raises the cost of distribution and moreover is not very effective since small and medium-scale farmers are served less well than large agricultural operations. Consideration should be given to loan terms that are identical regardless of the category of farmer and of the loan financing sources, with the object of eliminating the (extremely difficult) administrative control currently necessitated by the granting of differential subsidies according to farmer categories. Identical loan conditions would, incidentally, constitute a credit subsidy to small farmers.

(c) Inadequacy of intermediation spreads. The lack of initiative shown by the financial system in the financing of agriculture is due in large part to the inadequacy of authorized spreads on agricultural loans in relation to the costs of management and the high risks of such credit. In 1982, BNT's spread for agricultural loans was 1.1% of its total agricultural portfolio; however, it is estimated that the spread would need to be 5.0% in order to cover management costs, allow adequate provision for doubtful debts, and generate a satisfactory return on equity capital. Unless spreads are increased as indicated, the other commercial banks cannot be expected to show a heightened interest in agricultural lending.

(d) Accumulation of arrears. The rate of recovery on BNT's agricultural loans as of the end of 1983 was only 68%. The rate of recovery of loans made from budget funds (FOSDA) or guaranteed by the Government (SCMA) was below 50%. BNT and the Government have already taken action to improve the rate of recovery of farm loans, but the results to date have not been satisfactory. The seriousness of the present situation demands that the Government move decisively and quickly to lower the proportion of arrears in agricultural credit. Loan collection procedures should be made more efficient, more expeditious and less costly; the action to improve the solvency of the SCMAs should be pursued; and a study should be made of the possible extension of the "Privilège Général du Trésor" (for which FOSDA, SCMA and integrated project loans are already eligible) to other agricultural lending in order to bypass the extremely slow and complicated legal proceedings. In cases in which the arrears are essentially due to problems caused by the drought, rescheduling would be the appropriate solution, with the arrears being converted into medium-term debts.

(e) Problems of small and medium-scale farmers in gaining access to institutional credit. The number of farmers with access to seasonal credit, in cash or in kind, probably does not exceed 60,000, or less than 20% of all Tunisian farmers. The number of farmers who had received medium- and long-term loans at the end of 1983 was about 80,000, i.e. less than 25% of the total. Institutional credit is used primarily by farmers with medium-size and large holdings. The authorities have adopted some measures to better meet the needs of small and medium-scale farmers. These include earmarking part of the proceeds of external borrowings for them, the establishment of some special programs, exclusion of investments made by large-scale operators from some of the benefits stipulated in the August 1982 Law, and bolstering of the Sociétés de Caution Mutuelle Agricole (SCMAs). Despite these measures, the agricultural credit rationing currently being applied does not foster the use of credit by small and medium-scale farmers. Only by eliminating the reasons for credit rationing (large subsidies and incentives to expanded financing of the sector by the financial institutions) can an appreciable improvement in access by these farmers to institutional agricultural credit be brought about.

(f) Administrative intervention. A medium-term objective of the Government should be to reduce the use of budgetary resources for agricultural lending. Agricultural investments, particularly those of private farmers, should be financed through loans extended by financial institutions which should (i) be fully responsible for loan approval; and (ii) bear the entire associated credit risk. The role of government services, beside the definition of government's agricultural policy, should be to approve highly selective investment subsidies for priority investments and to supervise agricultural investments undertaken under development projects or benefiting from government subsidies.

VIII. Financing of Industry

47. Manufacturing industry has absorbed a growing proportion of credit from the banking system (deposit and development banks). In recent years, following the establishment of several well-capitalized development banks, their role in the financing of manufacturing companies has expanded considerably. The financing of industrial investment also depends in large measure on participation by the State; this refers not only to public enterprises but to private firms as well. The State acts mainly through the Fonds de Promotion et de Décentralisation Industrielle (FOPRODI), the Fonds de Promotion de l'Artisanat et des Petits Métiers (FOPRAM) and the Fonds National de Garantie (FNG).

48. FOPRODI's role is to support the establishment and expansion of small and medium-scale enterprises (SMEs), through funding for promoters to assist in the capitalization of enterprises, medium- and long-term loans for capital investment, and assumption, for an initial period of 6 months, of interest on medium- and long-term loans from the banking system. The following comments are offered in connection with these benefits:

(a) Interest rates on repayable advances, currently 3%, should be raised to 8-10%. In place of the subsidy based on equity capital, which is due to the sharply negative real interest rates that now prevail, it would be preferable to provide capital investment subsidies determined by specific project characteristics (e.g. employment created, contribution to exports, or value added at international prices).

(b) For similar reasons, the highly subsidized interest rate of 4% allowed on FOPRODI investment loans to SMEs should be increased to at least 10%, and FOPRODI's assumption of interest costs for the first six months of medium- and long-term bank loans should be eliminated.

49. FOPRODI also subsidizes interest rates for industrial projects in the less developed regions. The subsidies, which can be as much as 5%, are too high. They should be reduced and the minimum rate paid by the beneficiary should be at least 8%.

50. FOPRAM extends advantages to crafts enterprises and small skilled tradesmen similar to those granted by FOPRODI to SMEs. For the same reasons as just mentioned in connection with FOPRODI, advances from FOPRAM to finance equity capital should be repaid at interest of 8%, which would still be a heavily subsidized rate. Action should also be taken to eliminate the assumption of interest during construction on investment loans obtained from banks.

51. The Fonds National de Garantie (FNG) extends guarantees for firms receiving support from FOPRODI and FNPAPM. The guarantee commission payable by the beneficiary to FNG, while subsidized, should not be too low, in order to forestall heavy losses to the State budget and to increase the liability of promoters. At present, the guarantee commission of 1/8% is paid only once, at the beginning. This commission should be increased and made payable annually.

52. In view of the key role that exports of manufactured goods will have to play in Tunisia's economic development during the years ahead, it is imperative to broaden the benefits of the export credit system:

(a) Procedures for granting short-term prefinancing credit should be more automatic. For instance, it might be stipulated that subsidized prefinancing credits would be for a term of one year, with a normal ceiling of 20% of annual exports (except for exports of capital goods). This would ensure a uniform subsidy rate for all exports. Exporters of goods with a longer production cycle would also obtain nonsubsidized or slightly subsidized prefinancing credit to cover all of their prefinancing requirements.

(b) The system for mobilizing claims abroad is satisfactory at present. Any further extension of the term of short-term credits abroad should be avoided, so as not to encourage exporters to hold their funds abroad.

(c) There is an urgent need for a system of medium- and long-term export credit, with clearly stated regulations, but there is no need to set up a National Foreign Trade Bank for this purpose. The system can be based on the present deposit and development banks, supported by the Central Bank. The regulations should establish an integrated procedure for prefinancing credit and export credit, and should provide for close coordination with the system of export credit insurance.

(d) To supplement the system of export credit insurance -- which has recently been established but which will not cover risks of manufacture borne by the producer or the exporter -- it would be beneficial to allow for the possibility of having FNG cover those risks.

(e) The advantages extended to export-oriented investment should be revised (lowering of the minimum percentage of foreign sales entitling firms to benefits; replacement of subsidized interest rates by subsidies based on value added at international prices, in the case of large projects).

53. The following measures should be considered in order to enhance the contribution of the banking system to the financing of small and medium-scale enterprises:

- Granting to deposit and investment banks, by the Credit and Investment Subsidy Fund (FBCI) referred to in para. 44 (d), of a subsidy of 1% per year on their total medium- and long-term loans to SMEs, to compensate them for the higher financial cost of administering this credit:

- Requirement that deposit banks have medium- and long-term loans to SMEs equal to 7% of their deposits. This condition would be introduced gradually and would include loans to artisans and small skilled tradesmen, for which the present proportion of 2% would be eliminated.

- Establishment of rediscounting facilities at the Central Bank for medium- and long-term loans from development banks to SMEs.

IX. Financing of Housing

54. The main problems of the housing finance system are: (a) the high cost of subsidies and the resulting distortions; (b) the losses incurred by social security funds in their housing loans and in housing rentals, and the largely inequitable distribution of the benefits they provide; (c) the lack of land on which to build; (d) the fragmentation that results from the multiplicity of institutions involved in housing finance; (e) the rigidity of the terms of most housing loans; (f) the increase in the number of CNEL contracts under which borrowers must wait several years before using the loans to which they are entitled.

55. To reduce the cost of subsidies and correct the distortions that they cause, interest rates on housing loans should be raised to at least 8%, a rate which would still be heavily subsidized. To offset the rise in interest rates the term of loans should be increased to 20 years, and amortization schedules with increasing annual payments should be introduced. Subsidies under the FOPROLOS housing finance program should also be reduced. Interest rates on loans made by that Fund to wage-earners with incomes not exceeding 1.5 times the SMIG should be raised to at least 5.5%; personal loans to workers earning up to 3 times the SMIG should be terminated.

56. The investments of CNRPS and CNSS in rental housing cause those institutions to incur substantial losses and do not fulfill the social purpose of assisting the lowest-income families. In the current rental housing programs, rents should be raised to provide a better return to investors. The rental housing programs of CNRPS and CNSS should be terminated unless the rate of return on these investments can be raised to at least 7% per year.

57. Better financing facilities are needed for the purchase of building sites. To this end, CNEL should broaden the area of application of its

housing savings loans. CNEL and the commercial banks should make loans to AFH in order to facilitate the assembling of sites. The commercial banks should be encouraged to make medium-term loans to private developers for the purchase or assembling of sites for residential housing.

58. The following measures are needed to correct the fragmentation that exists in the housing finance system: (a) greater standardization of the conditions of housing loans made by different institutions (interest rates, terms, ceilings, etc.), and (b) better coordination of loans made by different institutions, especially as regards the cumulative amount of loans to a single beneficiary.

59. The following measures are needed to lessen the rigidities of housing finance: (a) periodic adjustments, geared to price increases, of the ceilings on the various types of housing loans (housing savings contracts with CNEL, FOPROLOS loans, loans made by social security institutions); (b) strict observance of the proportion of 5% CNEL bonds required of deposit banks, and use of funds raised thereby to purchase loans already made by CNRPS or CNSS or for the temporary refinancing of housing loans made by commercial banks; (c) broadening of CNEL financing to include not only the purchase of land but also loans for the renovation and enlargement of existing structures; and (d) development of housing loans of the noncontractual type, financed through the mechanism of voluntary savings and bearing higher and more attractive rates than those of the housing savings system, and by funds borrowed on financial markets.

60. To ensure the long-term success of CNEL's activities, it will be necessary to overcome the problem of housing savings contracts in which borrowers must wait several years for the loans to which they are entitled because of the lack of land or of houses for sale. To this end, the supply of land and houses will have to be increased and a higher rate of interest paid on housing savings deposits that have reached maturity. In principle, the rate should be equal to that paid on savings deposits at CENT with terms of over two years.

61. The introduction of more radical changes in the housing savings system might call for conversion of CNEL into a housing bank. The resources of the institution will continue to be obtained primarily through housing savings contracts, but other forms of savings would have to be attracted as well. The housing bank could issue bonds when capital market conditions permit. For the long term the possibility of issuing mortgage bonds should also be considered, but at present issues of this type would be premature, given the extent of development of the capital market.

X. Financing of the Treasury and the Public Enterprises

62. The financing requirements of the Central Government have grown markedly during the 1980s, from 2.8% of GDP in 1980 to 7.6% in 1984. In 1984 domestic sources financed almost three-fourths of State borrowing requirements, compared to one-fifth in 1980. About two-thirds of domestic financing has been provided by the banking system in the form of required subscriptions of capital equipment bonds by deposit banks. Among other sources of financing the major ones are deposits in postal checking accounts, deposits at CENT, and capital equipment bonds held by CENT.

63. Monetary financing of the consolidated State deficit has increased in recent years, and this has been a factor in the accelerated expansion of the money supply. It is therefore recommended that the Government reduce its use of bank financing not only to curtail the rapid increase in domestic liquidity, but also to avoid (while adhering to the objectives recommended for expansion of the money supply and domestic credit) "crowding out" of the credit needs of the nongovernmental sector. With this in mind, it is proposed that the Government issue development bonds bearing interest rates that will ensure a reasonable return, intended for purchase by households, insurance companies and social security institutions. The fundamental policy objective, however, should be to wean public enterprises away from Government budgetary resources.

64. There are about 300 enterprises in which the State directly or indirectly holds at least 10% of the capital stock, and which are regarded as public enterprises. The operating performance of most has worsened in recent years, and the financial situation of a number of them has become difficult. The public enterprises absorb over one-third of all bank credit. Budgetary allocations in the form of current operating subsidies, capital equipment contributions and subsidies and direct contributions to equity capital have climbed steadily, from 4.5% of GDP in 1981 to 5.9% in 1984.

65. A proposal for reform of the public enterprises was approved by the Council of Ministers on March 24, 1984. The implementation of the reform is to be based on several types of measures:

- reduction in budgetary allocations to the public enterprises;
- rehabilitation of certain public enterprises;
- withdrawal of the State from enterprises in which its involvement is not essential.

66. The reduction, and eventual elimination, of budgetary allocations to the public enterprises should be based on:

- the overall productivity objectives established under program contracts between the State and autonomous enterprises;
- the raising of prices of goods and services supplied by public enterprises, which have been kept too low;
- strict control of subsidies to compensate enterprises providing public services, which must charge unprofitable rates or prices or which are compelled to bear excessive costs for social or political reasons (labor costs in particular); these subsidies will have to be sized in the light of the stringent public finance situation.
- replacement of capital equipment financing for the enterprises by the Treasury by loans obtained directly by the enterprises from commercial banks, development banks and suppliers, or -- in the medium term -- by debenture issues on the financial market.

67. The authorities have already included an appropriation of TD 145 million in the 1984 State budget to finance the rehabilitation of enterprises. In addition, the Government is relying on the financial

institutions for additional support of its corrective measures, particularly through the conversion of some bank overdrafts to long-term debt, or of some long-term loans to shares.

68. The Government has already announced its intention to withdraw from the number of public enterprises that compete with other firms (i.e., excluding those responsible for providing public services, and natural monopolies), and to increase their management independence. In the initial phase the transfers would be made chiefly to development banks. The withdrawal will have to be gradual, mainly because of the limitations on the necessary resources that need to be mobilized by the development banks and in the capital market, and because it may be necessary to rehabilitate some public enterprises that would be candidates for withdrawal. The basic policy objective to be considered is whether there would be economic advantages in privatizing certain public enterprises.

69. The transfer of financial control of public enterprises from the State to the development banks will generally speaking have to be supported by reorganization programs aimed at improving management and operation which in many cases can be carried out only with additional investments. Eligibility for financing by the development banks should be limited to public enterprises that can become financially profitable and technically viable and can be managed on a commercial basis (without subsidies from or direct control by the State). If the Government finds that these criteria cannot be met by certain enterprises, it would be preferable to keep them under its control until substantive solutions can be found for improving their financial status. In particular, it may be necessary to liquidate some of those enterprises to avoid the heavy budgetary expenditures that they represent. Withdrawal of the State from the financing of public enterprises should make it possible to transfer to the development banks some of the financial resources that the Treasury is now obtaining from capital equipment bond issues and using to fund public enterprises.

XI. Capital Market

70. The capital market in Tunisia is not very well developed and is heavily dominated by the State and by institutional investors. The securities traded are limited basically to: (i) capital equipment bonds issued by the State at 5.5% interest and placed mainly through compulsory subscription by banks, insurance companies and social security institutions; (ii) compulsory borrowings, mainly by BDET and more recently by STUSID, bearing interest rates that are in general higher than those paid on capital equipment bonds and on time deposits (taking account of the tax advantages), about two-thirds being subscribed voluntarily by companies and private investors; and (iii) shares, a large proportion of which has been issued in recent years by banks and tourism companies. The volume of transactions on the secondary market is small.

71. Development of the capital market could help to expand and diversify the medium- and long-term financial resources available for Tunisia's economic development, strengthen the financial structure of many firms, make shareholding more democratic, heighten competition within the banking system, and diversify the supply of financial instruments, which should have a favorable impact on private financial savings. The potential for development

of the capital market is considerable, especially if (i) the Government implements its already announced policy of transferring some State equity holdings in public enterprises to private ownership; (ii) the development banks turn over their share portfolio as they intend to do; (iii) the development banks seek additional resources by issuing debentures for public subscription; and (iv) the country continues to attract substantial amounts of foreign capital, particularly from the Middle East.

72. Measures to develop the capital market can be grouped into four categories:

(a) Improvement of the supply of shares and bonds available on the market:

(i) The State should offer on the stock exchange larger quantities of shares of those companies controlled by it that are candidates for privatization. Part of the shares could be sold even if the authorities considered it necessary to maintain the State's majority holding in the capital of certain public enterprises. To prevent a slump in prices, sales should take place gradually, and it might be necessary to involve the financial institutions in the selling process. The subscription of shares offered by private individuals should be encouraged by the formation of Variable-capital Investment Companies (SICAVs);

(ii) The development banks should continue to issue bonds that directly tap private savings. Several types of bonds should be considered: fixed-rate bonds; adjustable-interest bonds (which could have amortization periods longer than those for fixed-rate bonds, since they would be less risky both for the issuer and for the subscriber); zero-coupon bonds (like those issued by STUSID); bonds convertible into shares, etc.

(iii) If issues of bonds by development banks are successful, similar issues should be offered by nonfinancial public enterprises and by private companies whose financial position is sound. These issues may require a State guarantee during the initial development of the capital market.

(b) Tax measures:

(i) The tax incentives for investors in securities require that purchasers hold the securities in their portfolio for five years to be eligible for exemption from the tax on securities income; it would be advisable to make this condition more flexible by allowing sales after three years, for example, although with tax advantages lower than those granted after five years;

(ii) Withholding at source of the IRVM on dividends places share investments at a disadvantage vis-à-vis bank deposits. It is therefore essential, for the sake of more balanced competition between shares and bank deposits, to reduce the IRVM rate to that of the income tax on time deposits, and to provide for withholding of the latter tax at the source;

(iii) The development of the securities market could be fostered by means of tax advantages for companies listed permanently, provided that those companies are subjected to stricter auditing procedures. To encourage the acceptance of the auditing and advertising requirements that would have to be imposed on listed companies, it might be possible to effect a slight increase (e.g. 1%) in the tax rate on profits of companies that are eligible for listing on the exchange but are not listed, and to lower (e.g. by 4%) of the tax rate on profits of listed companies. In addition, the tax on stock market transactions (TTB) should be lowered from 0.8% to 0.4% for transactions on the official market (permanent listing).

(c) Institutional changes:

(i) The formation of variable-capital investment companies (SICAVs), already provided for in the law, should be encouraged through tax advantages, particularly elimination of the risks of double taxation;

(ii) The role of insurance companies in the capital market should be enhanced by: (1) eliminating or reducing the legal requirement of subscription of capital equipment bonds by these companies, and (2) improving their financial position and profitability, especially in the field of automobile insurance;

(iii) It would be well to encourage the establishment, as stockbrokers, of individuals or companies specializing in the financial market, so as to increase competition with the banks, which now handle all securities market intermediation transactions.

(d) Protection of investors:

(i) To extend the advantage enjoyed at present by shareholders having privileged information, companies listed on the stock exchange should be obliged to publish a balance sheet and income statement at the end of every six months. It would also be worthwhile to set up a securities market commission with responsibility for: (1) verifying the accuracy of published information and seeing to its correction if necessary, and (2) approving the financial documents that must accompany all public offerings of new shares or bonds;

(ii) The bylaws of the Stock Exchange envisaged in Law 69-13 of February 23, 1969 should be drawn up and published. Among other provisions, they should include the regulation of relationships between subscribers and issuers, and the position of bonds with respect to shares;

(iii) Stockbrokers should not be legally permitted to engage in the buying and selling of securities of their own or their parent company, in order to avoid conflicts of interest and risks of manipulation with harm to investors.

Chapter I

DOMESTIC FINANCIAL RESOURCES AND INVESTMENT FINANCING

A. The Economic Setting

1.01 Tunisia's economic situation during the last decade was characterized by relatively rapid economic growth along with a favorable domestic and foreign financial position. During the 1970s the economy benefited from substantial terms of trade gains due to the relative increase in oil prices. Petroleum sector revenue not only provided an appreciable addition to domestic savings; it also boosted investment activity and thereby contributed to the growth of output, consumption and imports. The balance of payments and public finances situations, which had deteriorated appreciably by the beginning of the Fifth Plan (1977-81), improved during the Sixth Plan period (Table 1.1). The budgetary and external deficits were easily financed, thanks to the inflow of direct foreign investment and of loans, the oil price increases of 1979-80, and improved economic management during the Fifth Plan period.

1.02 Recently, the economy has experienced a slowdown, due to the shortfall in agricultural output and the decline in oil export prices. During the first two years of the Sixth Plan (1982-86), Tunisia's budgetary and balance of payments positions deteriorated seriously, owing mainly to the sharp rise in wages, the increase in subsidies and budgetary transfers, and the growth of the trade deficit. Although the deterioration, measured in relation to GDP, is not as severe as it was at the start of the previous Plan (1977), it is nevertheless cause for concern since its pace has been relatively fast. Moreover, contrary to previous years, the contribution of the petroleum sector to the economy is declining and it is unlikely that future oil price movements will restore the favorable financial position that Tunisia enjoyed during the last decade.

1.03 GDP, which had stagnated in 1982, mainly because of the drought, rose by 4.7% in 1983 and 5.5% in 1984. With this recovery the growth of the economy in the first three years of the Plan averaged 3.3%, well below the 5.4% average growth envisaged for that period. In contrast to production, demand continued to expand fairly strongly in 1982-84. Investment, though constant in real terms, exceeded 30% of GDP, compared to the Plan's average target of 27%. This high investment rate is more striking when compared to the number of jobs created, which fell short of the target by about 13%. At the same time, consumption growth, triggered in large part by the wage increases of the last two years, surpassed GDP growth, thus reducing the savings rate from nearly 24% of GDP in 1981 to about and 20% in 1984. The strong demand pressure is reflected in the inflation rate. The cost of living index rose by 13.6% in 1982, but inflation fell to about 9% in 1983 and 1984 following the tightening of price controls.

1.04 Together with the widening savings gap, the balance of payments current account deficit has also deteriorated in the last two years, owing mainly to the fall in net petroleum earnings and the increase in imports.

Thus, the current account deficit rose from 7.6% of GDP in 1981 to 9.4% in 1982 (Table 1.1). Following the tightening of import controls in 1983, the current account deficit declined to about 7.5% of GDP, but it rose again in 1984, to 10.4%. The deterioration in the current account position has led to a faster accumulation of external debt. In contrast to its policy in the past, Tunisia has had to turn to foreign financial markets. External public debt rose from 38% of GDP in 1981 to 49% in 1984. Debt service also rose rapidly, reflecting the appreciation of the US dollar relative to the major European currencies. Debt service rose from 14.6% of the value of current receipts in 1981 to over 20% in 1984. The growth of public expenditure accelerated in 1982-83, as a result mainly of the increases in the government wage bill, subsidies and other current transfers and the speedup in public-sector investment. The combination of increased expenditure and stagnating oil receipts led to a substantial worsening of the Administration budgetary deficit, to 6.7% of GDP in 1983 and 7.6% in 1984.

1.05 It is estimated that the growth rate of the Tunisian economy will dip to about 3.5% in 1985, in real terms, mainly as a result of a deceleration in the growth of the country's agricultural product, which in 1983 started out at low levels, being seriously affected by the drought of the previous years. Domestic savings could reach about 20% of GDP. Gross fixed investment is projected to fall by 3.3% in real terms. Consequently, the domestic resource gap should fall from 9.5% of GDP in 1984 to 8.6% in 1985. In the budgetary and fiscal area, the consolidated budget of all of the Administration sector would increase by 7.6% of GDP in 1984 to 8.8% in 1985. This increase reflects to a large extent the growth in current expenditures and also a substantial reduction in capital receipts (which in 1983 were inflated by revaluation of the assets of the Central Bank). With regard to the balance of payments, the current account deficit should slightly improve in relation to GDP, but it is nevertheless projected at around 9.6% of GDP. The country's total debt is estimated to exceed 53% of GDP by the end of 1985.

Table 1.1
Macro-economic Characteristics

	Annual Growth Rates (%) (Constant Prices)			Share of GDP (%) (Current Market Prices)		
	IV Plan 1972-76	V Plan 1977-81	VI Plan 1982-84	1977	1981	1984
GDP, EXPENDITURES AND SAVINGS						
GDP	8.8	6.3	3.4	100.0	100.0	100.0
Expenditures						
Consumption	9.6	7.6	4.6	80.1	76.1	79.7
Gross Investment	14.1	9.1	0.1	30.2	32.3	29.8
Exports GNFS	5.6	8.0	0.4	29.5	41.4	34.0
Imports GNFS	13.1	12.1	0.9	39.8	49.8	43.5
Savings						
Domestic Savings	2.9	2.5	-1.1	19.9	23.9	20.3
National Savings	2.9	3.6	-2.5	19.0	24.7	21.2

	As percent of GDP					
	1972	1977	1981	1982	1983	1984
Consolidated Government Budget						
Revenue & Grants	25.0	29.9	32.1	34.2	34.5	35.4
Current Expenditure	19.0	21.9	21.9	26.4	27.5	30.6
Capital Expenditure	4.1	12.1	12.7	12.9	12.5	12.5
Deficit	-1.0	-6.0	-2.5	-5.1	-5.5	-7.7
Balance of Payments						
Trade balance	-5.2	-15.6	-13.7	-15.4	-13.4	-15.3
Service balance	3.0	4.6	5.2	4.9	4.7	4.3
Transfers	0.5	—	0.9	1.1	1.3	0.4
Current Account Deficit	-1.7	-11.0	-7.6	-9.4	-7.5	-10.4

Source: Ministry of Planning

B. Structure of Savings

1.06 The rapid growth of output and income in Tunisia has been accompanied by a faster growth of consumption than of GDP, resulting in a steady deterioration in the savings position. As a result, annual growth of domestic savings has declined from 2.9% during the Fourth Plan to 2.5% during the Fifth Plan and -1.3% in the first three years of the Sixth Plan. Thus, the share of domestic savings in GDP, about 24% at the end of the Fifth Plan, fell steadily in the first two years of the Sixth Plan and is projected at 20.8% of GDP in 1985.

1.07 The deteriorating savings performance has been fairly pronounced in the case of the Administration sector, which accounts for over 40% of total savings and includes the central government, the local authorities, the social security system and special funds. The marginal savings performance of the Administration sector has dropped from nearly 33% of current revenue in the Fifth Plan to around 14% in the last three years. Thus, Administration saving, which increased as a share of GDP in the late 1970s, has been declining steadily since 1980, falling from about 11.3% of GDP that year to 8.6% in 1984. The marginal savings propensity of the enterprise and household sectors has also declined, though more slowly. The combined marginal savings rate of these two sectors, close to 20% during 1977-81, has dropped to about 13% in 1982-84. 1/

1.08 It should be noted that Tunisia's national accounts do not break down savings between private and public enterprises. In fact, household and Administration savings are estimated directly and the savings of the enterprises (private and public together) are determined residually. 2/ However, a sample of 50 of the largest public enterprises, operating in nine different sectors, indicates that the savings of these enterprises, which on average account for 3% of GDP, increased in current terms by over 9% a year

1/ Gross savings are related to income in each sector. However, because of the insufficiency of official data on separate household and enterprise income, the combined income of these two sectors has been taken to be the difference between Administration income and gross national income.

2/ These estimates, especially in the case of Administration savings, differ from those obtained from the consolidated financial operations of the central government, which are calculated using the IMF method from the Government Financial Statistics (GFS). The differences derive essentially from: the statistical coverage, particularly for the social security system; the treatment of repayment of military loans; and the exclusion of local authorities from the GFS methodology. There are also differences in the treatment of transfers. For example, in 1984 about TD 90 million of profits of the Central Bank from re-evaluation gains in 1983 was transferred to public enterprises to offset their foreign exchange losses on debt service payments. The official statistics treat this amount as capital transfers, whereas the GFS statistics treat it as current expenditure.

between 1979 and 1983. 1/ However, the bulk of the resources were generated by the few oil-sector enterprises. Leaving out enterprises, the savings performance of the other enterprises shows a declining trend over this period. This is due in part to the very large wage increases of 1982-83 and price control, particularly in 1983.

1.09 Household savings 2/ have remained at between 8 and 9% of GDP since 1980 (Table 1.3). 3/ The share of financial savings 2/ in total household savings rose from about 30% in 1980 to 45% in 1983 and is estimated to have risen again in 1984. The increase in the share of household financial savings was concurrent with the rise in interest rates in 1981 and in wages in 1982-83. It also took place at a time when restrictions on imports were being tightened, which suggests a possible inertia of consumption rather than an increased savings effort.

C. Structure of Investment

1.10 The ratio of investment to GDP is high in the Tunisian economy. Following a substantial increase in investment growth, particularly during the Fourth and Fifth Plans, the share of investment rose from about 20% of GDP at the beginning of the Fourth Plan to about 30% by the end of that Plan in 1976, and since then has fluctuated around that level. The most important factors contributing to this high level of investment have been: (a) the low interest rates and the reductions in or exemptions from import duties on capital goods; (b) the ready availability of financial resources following the oil price booms of the middle and late 1970s and the increased production of other mineral resources such as phosphates; (c) the laws of 1972 and 1981 which offered incentives to investment in manufacturing, and (d) the favorable climate for foreign investment, which accounted for about 7.5% total investment in the early 1970s and over 12% in the early 1980s.

1.11 The high level of investment contributed to an impressive growth of output in the last decade. Growth of output reached 8.8% during the Fourth Plan and 6.3% during the Fifth Plan (Table 1.1). Nevertheless, despite the high growth of output and investment, productivity of investment remained low. The incremental capital/output ratio (ICOR) doubled in the last decade, from 2.7 during the Fourth Plan to 5.5 during the Fifth Plan, reflecting in part the concentration on highly capital-intensive projects. The ratio has worsened further in the first three years of the current Sixth Plan, to around 8.8, and without an effort to increase productivity will remain high during the remaining years of this Plan. The level of investment per job created has also remained high. The main goal of the present Plan has been to devote

1/ Savings are calculated as profits minus taxes plus depreciation minus operating subsidies.

2/ Household savings are defined as the sum of financial savings plus self-financing in housing and construction, excluding transfer payments.

3/ This is also consistent with the statistics published in a study on household saving for the years 1979-82 by the Bach Hamba Institute of Quantitative Economics. According to this study, the marginal saving performance of the household sector increased significantly during 1981-82.

Table 1.2

Saving, Investment & Financing of Resource Gap
(Millions of current dinars)

	1977	1981	1982	1983	Est. 1984
GDP (Market Prices)	4162	4842	5485	6173	
Net Factor Income	19	36	56	35	30
GNP (Market Prices)	2182	4198	4898	5520	6203
Consumption	1764	3169	3780	4360	4923
Domestic Savings	437	993	1062	1125	1250
National Savings	418	1029	1118	1160	1280
Investment	663	1345	1560	1610	1780
Changes in Stocks	(-3)	(55)	(20)	(-15)	(30)
Resource Gap	-226	-352	-498	-485	-530
Financing	226	352	498	485	530
Net Transfers	-	36	56	35	30
Grants	20	10	11	15	15
Net Direct Foreign Invest.	40	181	238	165	180
Net MLT loans	269	136	186	280	285
Others 1/	-103	-11	7	-10	20

Source: Ministry of Planning

1/ Includes short-term capital movements, change in foreign assets, and errors and omissions.

Table 1.3

Investment and Saving
(As percent of GDP)

Total Economy	1977	1980	1981	1982	1983	Est. 1984
Investment 1/	30.6	28.3	30.9	31.9	29.7	28.3
Domestic Savings	20.5	24.0	23.9	21.9	20.5	20.2
Resource Gap	-10.1	-4.3	-7.0	-10.0	-9.2	-8.1
Administration 2/						
Investment	5.6	4.6	5.1	5.3	5.4	4.9
Savings	7.0	11.3	9.8	9.3	9.0	8.4
Gap	1.4	6.6	4.7	4.0	3.6	3.5
Enterprises						
Investment	20.5	18.8	21.5	22.4	20.0	19.4
Savings	7.6	6.8	7.4	5.9	4.3	5.0
Gap	-12.9	-12.0	-14.1	-16.5	-15.7	-14.4
Households						
Investment	4.5	4.9	4.3	4.2	4.3	4.0
Savings	5.9	5.9	6.7	6.7	7.2	6.8
Gap	1.4	1.0	2.4	2.5	2.9	2.7

Source: Ministry of Planning

1/ Excludes changes in stocks.
2/ Includes central government, local authorities, social security system, and operations of special funds.

Table 1.4

Investment and Savings, 1977-1984
(Millions of Dinars)

Total Economy	1977	1980	1981	1982	1983	Est. 1984
Gross Investment 1/	670	1039	1345	1560	1610	1780
Current Account Deficit	244	168	316	442	450	500
National Savings	426	871	1029	1118	1160	1280
Net Transfers	23	22	36	56	35	30
Gross Domestic Savings	449	849	993	1062	1125	1250
Administration						
Investment	123	164	214	257	295	305
Savings	153	399	409	450	494	520
Gap	30	235	195	193	199	215
Enterprises						
Investment	447	664	898	1082	1095	1195
Savings	166	242	307	288	237	311
Gap	-281	-422	-591	-794	-858	-884
Households						
Investment	100	174	178	201	235	250
Savings	130	208	277	324	394	419
Gap	30	34	99	123	159	169

Source: Ministry of Planning

1/ Includes changes in stocks	-2	37	55	20	-15	30

the bulk of investment to employment creation. Nevertheless, the number of jobs created during the years 1982-84 fell short of the projected total by around 50,000. The level of unemployment has thus remained high. Despite the fact that over 28% of investment under the Plan has been allocated to highly labor-intensive industries, only 22% of investment was used for these industries in the first two years of the Plan. Moreover, total investment per job has risen by 26%, from an average of TD 23,000 during the last plan period to about TD 38,900 during 1982-84, 1/ against a projection of only TD 25,500 for that period.

1.12 The major share of investment during the last two plans has been concentrated in the industry, housing and transportation sectors, which together accounted for over half of investment in the last decade. Similarly, during the last two plans, the share of government and public enterprises in the total investment effort was 56% and that of private enterprises and households 44%. These shares have remained unchanged during the current Plan so far, in spite of the intention to raise the share of private investment. Public enterprise involvement in investment activities has been largest in the extractive industries, transportation and manufacturing. The public enterprises' share in total investment has risen steadily since 1980, reflecting the capital-intensiveness of their investment efforts. Thus, the public enterprises' contribution to total enterprise investment, about one-half in 1980, will rise to an estimated two-thirds in 1983. Similarly, their share in total investment, 35% in 1980, is expected to rise to 41% this year.

D. Financing of Investment

1.13 During the Fourth Plan period (1972-76), domestic savings sufficed on average to finance about 78% of investment. This proportion fell to 75% during the Fifth Plan (1977-81) and to 70% during the first three years of the Sixth Plan (1982-84). As a result, the savings/investment gap widened from 6% of GDP in the Fourth Plan to 7% in the Fifth Plan and 10.2% in the first three years of the Sixth Plan. The major reason for the relatively small and stable resource gap during the earlier periods was that capital expenditure, which had risen rapidly during the Fourth Plan period, leveled off to some extent in subsequent years. Moreover, the terms of trade improved significantly, owing to the sharp rise in crude-oil export prices in the early 1970s. The rapid worsening of the domestic resource gap in the last two years conflicts with the Plan's target of maintaining the gap at around 6.7% of GDP on average.

1.14 The resource gap has been financed through a continuous increase in the inflow of foreign resources, with investment the major component (Table 1.2). The bulk of foreign investment has gone to the petroleum industry (about 70% in the last three years) and the rest to offshore industries, direct investment in tourism, and development banks. Foreign investment, which averaged about 18% of the resource gap at the beginning of the Fifth Plan, had increased its share to more than one-half by the end of the Plan period and, on average, financed nearly one-third of the resource gap and

1/ The Mid-Term Plan Review Report of 1984 and the April 1985 Investment Control Report furnish detailed analyses of investment during the Sixth Plan.

about 8% of total investment. The establishment of new development banks in 1982 provided an additional channel for foreign investment. Since then, foreign investment has risen to about 40% of the resource gap and about 13% of total investment. The balance of the resource gap has been covered mainly by medium- and long-term foreign loans (Table 1.2). Overall, the share of external resources in total investment has risen from an average of 21% during the Fifth Plan to about one-third in the first three years of the Sixth Plan. In addition, grants and transfers have covered about 3-4% of total investment.

1.15 The increase in the share of external resources in investment is due to the inadequacy of the domestic saving efforts, in varying degrees, of households, enterprises and government, as indicated in Section B. Analysis of investment financing by these various agents is complicated by several factors: (a) there are various financial flows between the Government and the public enterprises; (b) these flows not only finance investment but also cover operating costs, and (c) different results are obtained depending on whether these flows are treated from the national accounts standpoint or from that of the consolidated financial operations of the Central Government.

1.16 According to the national accounts estimates, the administration and household sectors show a savings/investment surplus 1/ which is transferred to the enterprise sector, consisting of both public and private enterprises (Table 1.13). In the case of the public enterprises, the transfers from the State budget are the principal domestic source of investment funds. These transfers take the form mainly of equipment subsidies, capital participations and loans. Between 1981 and 1983 equipment subsidies financed over 29% of the public enterprises' total investment requirements and accounted for over 72% of the total financial support by the Government to these institutions (Tables 1.5 and 1.6). Altogether, the Government's financial support has covered about 38% of the enterprises' investment needs since 1981. Another equally important source of public enterprise investment financing has been foreign loans which, on average, covered about 37% of their capital requirements in the same period. The rest was financed by bank credit and own sources.

1.17 If, on the other hand, the above-mentioned transfers from the Government are treated as part of Treasury operations and of central government capital expenditure, as shown in the statement of consolidated financial operations of the central government, the government sector also has a resource deficit. 2/ In this case, central government savings, which financed about two-thirds of government investment in the Fifth Plan, sufficed to finance only about one-half over the 1982-84 period. Thus, the volume of resources required to finance the government deficit has risen from about 4% of government investment during the Fifth Plan to 30% since 1982 (Table 1.7). 3/

1/ Household investment comprises chiefly investments in housing. Administration investment comprises direct investment from the budget (Title II) adjusted for purchase of land, military expenditures, and investment by local authorities, the social security system and the Rural Development Program.

2/ This treatment conforms to that used by the IMF (GFS methodology). See the section on Public Savings in Chapter II.

3/ This is consistent with the increase in domestic borrowing by the central government as shown in the consolidated budget figures.

Table 1.5

Financial Flows from Government to Public Enterprises
(Millions of Dinars)

		1977	1981	1982	1983	Est. 1984
1.	Equipment subsidies	61.6	146.3	162.6	197.7	218.6
2.	Capital participation	28.6	4.6	17.7	16.8	80.2
3.	Loans	26.6	33.9	25.1	18.9	6.7
4.	Operating subsidies	11.3	21.2	20.3	28.2	15.5
	Total	128.1	206.0	225.7	261.6	321.0

Source: Ministry of Planning

Table 1.6

Investment Financing in Public Enterprises
(Millions of Dinars)

	1977	1981	1982	1983	Est. 1984
Transfers from government 1/	116.8	184.8	205.4	233.4	305.5
Foreign loans	104.3	182.5	251.0	220.0	250.0
Bank credit and own financing	84.9	94.5	151.8	215.5	171.0
Total investment	306.0	461.8	608.2	668.9	726.5

Source: Ministry of Planning

1/ Includes equipment subsidies, capital participation and loans.

Table 1.7

Investment Financing and Consolidated Financial Accounts of the Central Government (Percentage)

	Total Economy		Government	
	1977-81	1982-84	1977-81	1982-84
Savings	75.3	69.2	67.8	50.0
Net Transfers from Abroad	3.0	3.1	3.0	0.8
Net External Borrowing & Inv.	21.2	27.7	25.1	19.1
Net Domestic Transfer	-	-	4.1	30.1
Total Investment (million dinars)	100.0 (4666)	100.0 (4961)	100.0 (1976)	100.0 (2080)

Source: IMF, Government Financial Statistics and Staff Reports.

E. Medium-Term Prospects 1/

1.18 Tunisia's savings rate has been one of the highest among the middle-income oil-exporting countries. It will therefore not be easy to raise this rate. Nevertheless, given the size of its financial requirements and the downward trend of oil receipts, Tunisia cannot continue to rely on an inflow of foreign resources to finance investment of a level similar to that of recent years. Maintaining domestic savings at a high level is therefore a vital concern of economic policy. In assessing the prospects for financing a larger share of investment from domestic savings it is important to evaluate the medium-term prospects for the economy in light of the oil situation and of the external debt build-up required to finance the balance of payments current account deficit.

1.19 In the short term, as mentioned earlier, growth should be more rapid than during the early years of the Sixth Plan. Output is estimated to grow, in real terms, by 3.5% in 1985 and to sustain a probable growth momentum of around 4% in 1986 (Table 1.8). Gross investment is projected to fall slightly in real terms in 1985. Furthermore, the World Bank's Plan Review Report recommends leveling-off and even reduction of this gross investment (in order to avoid pressure on imports), combining it with improvement of the overall productivity of existing investments. In view of the difficulty in controlling consumption growth, the domestic savings rate is expected to rise only marginally. The current account deficit is not expected to improve substantially in 1985 and 1986 in view of the steady fall in net oil exports. Over the next two years, therefore, it could remain over 10% of GDP, unless

1/ The projections presented in this section are preliminary and may be altered in light of alternative scenarios put forward by the Mid-Term Plan Review Mission.

the policies of control of domestic demand are strengthened, as the Plan Report recommends. Financing a current account deficit of this magnitude would be very difficult and would lead to a further increase in the external debt, which already exceeds 50% of GDP. To avoid a rapid build-up of foreign debt and major economic strains in the medium run, policies aimed at controlling the growth of total domestic demand and reducing the external deficit must receive top priority.

1.20 The longer-term growth prospects of the Tunisian economy depend in part on developments in the oil sector and in part on an appreciable improvement in investment productivity and maintenance of competitiveness on external markets. The Plan Review Report examines the prospects and the necessary policies for accomplishment of these goals.

1.21 The combination of unfavorable terms of trade and budgetary imbalances will undoubtedly affect the level of national savings and will particularly limit public-sector savings as receipts from oil exports decline. In the medium term, the outlook for the economy will depend essentially on the success of the policy designed to maintain national savings at a high level in order to reduce the external resource gap and maintain a low level of foreign debt. The investment rate will probably decrease.

1.22 Maintaining a high rate of saving will call for considerable savings efforts on the part of the central government, public and private enterprises and households. Given the low level of self-financing by public enterprises, priority will have to be given to measures to improve the raising of domestic resources. At the same time, in view of the already high tax burden in Tunisia, the efforts to increase government savings will have to focus on improving public-sector resource management and containing the growth of current expenditure. Finally, the large volume of household savings potentially available makes it important to ensure that they are mobilized and used efficiently. 1/

1.23 Even if the efforts to improve resource mobilization are successful, the past high level of investment cannot be sustained except at the cost of excessive dependence on foreign resources and a sharp rise in debt service payments. The authorities have already started to take steps to reduce the investment rate. The April 1985 report of the National Investment Control Commission (Commission Nationale de Maîtrise d'Investissement) recognizes that it will be impossible to keep the investment rate at around 30% as in recent years. One of the goals of this report is to bring the investment rate down to more moderate levels, averaging on the order of 25% over the next few years, so as to alleviate pressure on the balance of payments (35% of investments are directly imported) and to reduce the strain on the public finances (an average of 30% of investments are financed by the budget). To control investment, the authorities are considering introducing the following measures:

(i) granting of more advantages for capital expenditure on renewal, maintenance and expansion than for investments designed to finance new

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1/ Specific measures to increase public and private sector saving are discussed in the following chapters.

ventures; this new approach will make it possible to improve the expected effects of a given level of capital expenditure on output, employment and the balance of payments;

(ii) review of advantages granted to nonpriority sectors and projects, in particular building, trade and transportation;

(iii) re-wording of the various investment codes to strengthen selectivity in favor of priority projects and to replace the many advantages granted those projects (fixed-rate registration, exemption for imports of capital goods, exemption from the tax on profits, etc.) through a subsidy graduated on the basis of simple criteria (employment cost, effect on the balance of payments, geographic location) granted in the form of a tax credit;

(iv) improvement of facilities and incentives in favor of investment by SMEs in the industrial sector, in particular by making acceptance and approval facilities more flexible, by strengthening API assistance to the promoters of such investment, and by awarding credit advantages;

(v) partial replacement of the enterprises' contributions to the social security system by a tax, to ensure greater control over labor costs; a possible alternative would be the introduction of a tax on output or on profits, to take the place of part of the wage-based social tax (prélèvement social);

(vi) application of stricter criteria governing the choice, appraisal and monitoring of public investment.

1.24 The medium-term projections beyond the Sixth Plan (Table 1.8) suggest that Tunisia needs to control domestic demand and imports and to have a lower growth rate in order to hold the resource gap at around 7-8% of GDP and limit external capital requirements and foreign debt to acceptable levels. The present level of Tunisia's debt is less cause for concern than its recent increase. 1/ Continuation of this trend will lead to debt-service difficulties in the future. The projections also assume that while imports will grow more slowly (GDP elasticity of 1.0), the decline in the oil share of exports should be largely offset by the faster growth of exports of manufactures, notably textiles, chemicals and food products but also non-traditional industrial products. The favorable export hypothesis (15% in volume) assumes that the competitive edge of Tunisia's exports, based on its competitive labor cost, will be maintained in Western Europe (which accounts for about 70% of its market). It is assumed also that the Government will speed up implementation of the measures to reduce consumption and demand for imports, which was a major goal of the Sixth Plan. With a slower growth of consumption and a faster expansion of exports, a large share of investment could be financed by domestic savings.

1.25 The estimates indicate that with 5.3% real growth of savings during the second half of this decade, close to 70% of investment could be financed

1/ Compared with the other medium-income countries, Tunisia's economy has a high export percentage. Consequently, while its external debt service rate is lower, its debt/GDP rate is appreciably higher.

by domestic savings in 1991. By then, external borrowing commitments and capital account would stand at reasonable levels, allowing the annual debt-service ratio to be maintained at 20% on average. This would constitute an important rate in view of the dwindling oil export receipts, which were the mainspring of the high level of savings in the 1970s. If the resource mobilization efforts failed to provide additional savings and domestic savings fell short, a larger inflow of foreign resources would be necessary. However, heavier external borrowing would not be tolerable in view of the existing high level of external debt and the severe debt-service burden on the balance of payments. So long as the main imbalance between saving and investment lies in the public sector it will be difficult to ease the strain on overall domestic resources. Serious efforts will be needed to finance a larger proportion of investment through additional savings in the public sector, especially the public enterprises.

Table 1.8

Average Annual Growth
(Constant 1980 Prices)

	VI Plan 1/		VII Plan 1/
	1982-84	1985-86	1987-91
GDP	3.4	4.0	3.0 à 4.0
Expenditures			
Consumption	4.6	4.7	3.0 à 4.0
Gross Investment	0.1	5.1	0.6 à 1.3
Exports of GNFs	0.4	3.6	5.0 à 6.0
Imports of GNPs	0.9	5.6	3.0 à 3.7
Savings			
Domestic Savings	-1.1	0.6	5.3 à 6.3
National Savings	-2.5	-0.3	4.4 à 5.7

Source: Mid-term Plan Review Report.

1/ These estimates reflect relatively modest growth scenarios consequent on the contraints resulting from the institution of economic structural adjustment policies and from the need to hold Tunisia's external debt below 50% of GDP.

Chapter II

SAVINGS MOBILIZATION

A. The Major Components of Domestic Savings

2.01 It was mentioned in Chapter I that between 1981 and 1984 the rate of national savings in relation to GDP fell from 23.8% to 20.3% as a consequence of the decline in savings of the public sector (from 9.3% to 8.6% of GDP) and of the enterprises (from 7.0% to 2.9% of GDP) and in spite of the increase in household savings (from 7.8% to 9.2% of GDP). It was also mentioned that, in view of the need to reduce the deficit on balance of payments current account and slow the rate of growth of external debt, the downward trend of the savings rate in recent years must be reversed or at least halted in order to avoid substantial reductions in investment rates. Achieving this goal will call for measures in relation to government, enterprise and household savings.

2.02 Comments on government savings are presented in Section B of this chapter and analyses of household savings mobilization in the following sections. The problems of enterprise savings are equally important but are not examined in the present report except, incompletely, for the public enterprises (see Chapter IX).

2.03 Increasing enterprise savings depends at the macro-economic level on the rate of growth of GDP, price and wages policy, world prices, the exchange rate, fiscal policy, and so on. At the individual enterprise level, in view of low allround productivity, increased savings also depend on efforts to improve management and introduce more effective production methods. The impact of financial policy on enterprise savings is uncertain. Raising interest rates could discourage recourse to credit and increase self-financing but could also reduce profits and thereby the rate of self-financing. Moreover, the development of the capital market and the improvement of the efficiency of the credit system will make self-financing less necessary and could therefore contribute to reducing enterprise savings. It must be stressed, however, that if reduced self-financing results from the development of the capital markets and of credit there will in principle be an improvement in the efficiency of utilization of financial resources.

2.04 The possibilities for rapid improvement in enterprise savings are small since the recent overall trend shows a contraction of profits and, therefore, of self-financing capacity. According to the most recent data furnished by the Survey of Industrial Activities (Recensement des Activités Industrielles) carried out by the National Statistics Institute, gross operating profits of the industrial enterprises as a proportion of total value added fell from 57% in 1980 to 47% in 1981.

B. Public Savings

The recent downward trend in public savings

2.05 As explained in footnote 1 to paragraph 1.8, there are two methods of evaluating administration savings: one based on the national accounts and another based on the IMF method applied to Treasury financial statistics. The public savings rates estimated by the second method are lower than those of the national accounts but they show the same declining trend since the beginning of the 1980s. Estimates using the second method put public savings in 1984 at only 4.8% of GNP, against 9.2% in 1980, and at only 38.5% of public capital expenditure, against 72.7% in 1980. The decline in savings is due to the unfavorable development of receipts and expenditures: whereas current receipts have increased only slightly (from the equivalent of 31.4% of GNP to 35.3%), current expenditures have risen rapidly, from 22.2% to 30.5% of GNP.

The recent trend of receipts

2.06 On the receipts side, oil revenues, which reached a record level in 1982, subsequently declined as a consequence of the substantial weakening of demand and of a fall in net receipts from oil exports, reflecting lower world prices and the leveling-off of local production. According to the preliminary estimates, oil receipts accounted for 14.1% of current receipts and 5% of GNP in 1984, against 19% and 6.4%, respectively, in 1982 (Table 2.1). Moreover, during the period 1980-84, income and profits taxes consistently accounted for a very low percentage of GNP (generally under 5%). The taxes on goods and services also fell as a percentage of GNP.

2.07 The only notable increase in receipts concerns import duties, the revenue from which is estimated at 28.8% of GNP in 1984, against 23.8% in 1980. This increase is attributable largely to the upward adjustment of import duties.

The recent trend of expenditure

2.08 On the expenditure side, the 1980s were characterized by particularly sharp increases in the government wage bill, interest charges on debt, and subsidies and other current transfers. The government wage bill almost doubled during the period 1981-84, mainly as a consequence of sharp rises in the number of government employees and in the salaries and wages scale in 1982-83 (Table 2.3). Debt interest nearly tripled during the period 1981-84, partly as a consequence of the depreciation of the Tunisian dinar in relation to the US dollar.

2.09 However, the major factors in the increase in current expenditures have been subsidies and other current transfers, which have tripled since 1980 and which accounted for around half of the increase in current expenditures during the period 1981-84. According to the estimates, in 1984 subsidies and other current transfers became the major component of current expenditure, representing over 40% of such expenditure, i.e. 13% of GNP. The consumer subsidies relate essentially to grain products, although they apply also to other products (for example, fertilizer, sugar, olive oil, milk and meat). Transfers to households consist mainly of the services provided by the various social security funds. The sharp increases that have taken place since 1982 are due to the expansion of retirement expenditures and to the extension of social security coverage to all wage-earners in the modern sector. Current transfers to the non financial public enterprises were relatively small until the end of 1983, but according to the estimates rose substantially in 1984. However, a large part of this growth (TD 90 million) is to be regarded as exceptional in nature: exceptional profits made by the Central Bank of

Tunisia through exchange rate gains in 1983, transferred (via a new special consolidation fund) to the public enterprises to offset the exchange losses they suffered through debt service payments.

Public savings in coming years

2.10 The outlook for the years ahead is overshadowed by the unfavorable forecast for fiscal revenue from oil production and from imports. Oil receipts are currently projected to decline further; these projections are based on prevailing world market prices and the expectation of a continuing decline in Tunisia's net exportable surplus. In addition, import receipts should rise less rapidly than in the past if, as expected, imports grow more slowly than GNP and if customs duties are not increased.

2.11 In order to correct the trends indicated by the projections and to maintain the level of public savings, the Tunisian authorities need to step up their efforts to improve the collection of non-oil tax revenue. However, in view of the already high level of the ratio between fiscal revenue and GNP, the efforts should be directed mainly at tighter control of the growth of current expenditure.

2.12 In spite of the constraints resulting from the high tax burden, substantial positive results can still be achieved through the tax reform that has already been initiated. This reform seeks to improve the equity and efficiency of the system by simplifying taxes rather than by raising the tax burden. In the case of direct taxes, in addition to widening the tax base, the reform seeks to standardize the tax system through progressive restructuring while lowering the tax rates for individuals (from 35% to 25%) and for companies (from 46% to 40%). In the case of indirect taxes the reform will progressively widen the application of the value added tax so that it can replace certain direct taxes which have already been reduced by several percentage points. The average rates applicable at the present time are 44% for individuals and 29% for companies. In addition, the value added tax has been extended to public works and other construction projects, the transportation of goods, and certain wholesale commerce operations. The taxes on foreign trade should also be modified to rationalize the effective degree of protection afforded local producers.

2.13 Additional improvements could be achieved by strengthening the measures to combat tax evasion. The increase in the domestic prices of certain oil products can also make a substantial contribution to increasing tax revenues. One of the goals of the Sixth Development Plan (1982-86) is to equalize the domestic and world prices of those products between now and 1986. In 1984, average domestic prices, including taxes, were equivalent to only around 90% of the corresponding world prices, but in early 1985 the authorities increased them by an average of 12%, which will increase tax revenues by approximately TD 30 - 50 million a year.

2.14 However, in view of the already high tax burden -- about 30% of GDP, not counting oil receipts -- the Government's efforts to avoid a decline in the rate of public saving should focus on control of recurrent expenditures. This control should be directed mainly to wage expenditures and transfers to consumers and public enterprises. The 1985 budget reveals significant efforts by the Tunisian authorities in this direction. The increase in budgeted

Table 2.1
TUNISIA - Consolidated Financial Operations of the Central Government 1/, 1980-84
(millions of dinars)

	1980	1981	1982	1983 Prelim. Figures	1984 Budget
Total Receipts and Donations	1,131.2	1,334.6	1,655.7	1,890.1	2,187.6
Current Receipts	1,108.5	1,315.1	1,646.4	1,883.4	2,187.5
Capital Receipts	0.5	0.8	0.9	1.1	0.5
Donations	22.0	5.4	8.4	6.6	0.6
Adjustment	--	13.3	--	-1.0	-1.0
Total Expenditures	1,230.1	1,440.1	1,903.9	2,193.3	2,660.9
Current Expenditures	784.1	909.9	1,280.2	1,507.4	1,891.1
Capital Expenditures	446.0	530.2	623.7	685.9	769.8
Current Savings	324.4	405.2	366.2	376.0	296.4
Overall Deficit (-)	-98.9	-105.5	-248.2	-303.2	-473.3
Financing	98.9	105.5	248.2	303.2	473.3
External (net)	80.4	108.7	176.0	74.9	146.4
Domestic (net)	18.5	-3.2	72.2	228.3	326.9
Ratios (% of GDP)					
Total Receipts and Donations	32.0	32.0	33.8	34.2	35.3
of which: Current Receipts	(31.4)	(31.5)	(33.6)	(34.1)	(35.3)
Total Expenditures	34.8	34.5	38.9	39.7	42.9
Current Expenditures	(22.2)	(21.8)	(26.2)	(27.3)	(30.5)
Capital Expenditures	(12.6)	(12.7)	(12.7)	(12.4)	(12.4)
Current Savings	9.2	9.7	7.5	6.8	4.8
Overall Deficit (-)	-2.8	-2.5	-5.1	-5.5	-7.6
Current Savings/ Capital Expenditure	72.7	76.4	58.7	54.8	38.5

Source: Data furnished by the Tunisian authorities.

1/ Includes all Treasury account transactions, off-budget expenditures financed by external aid, and social security operations.

Table 2.2
TUNISIA - Consolidated Current Receipts of the Central Government 1/, 1980-84
(millions of dinars)

	1980	1981	1982	1983 Prelim. figures	1984 Budget
Income and profits taxes	162.2	203.0	242.8	251.8	280.3
Social security contributions	102.9	117.3	146.9	178.6	194.5
Land taxes	25.9	26.2	34.2	38.1	40.1
Taxes or goods and services	264.5	310.6	345.0	405.2	442.2
Turnover taxes	(56.3)	(67.4)	(80.5)	(122.0)	(133.3)
Consumption duties	(79.9)	(116.4)	(126.8)	(147.2)	(183.6)
Taxes on provision of services	(35.4)	(38.5)	(52.1)	(65.9)	(62.6)
Fiscal monopolies	(52.4)	(50.1)	(43.7)	(16.7)	(--)
Consumer taxes	(40.5)	(38.2)	(41.9)	(53.4)	(62.7)
Taxes on foreign trade and international transactions	273.3	329.6	450.2	579.2	642.7
Import duties	(263.6)	(316.8)	(438.7)	(568.1)	(630.1)
Export duties	(9.7)	(12.8)	(11.5)	(11.1)	(12.6)
Land revenue	214.4	291.6	363.4	372.2	512.2
Oil receipts 2/	(173.4)	(225.9)	(312.6)	(308.7)	(309.3)
Miscellaneous	(41.0)	(65.7)	(50.8)	(63.5)	(202.9)
Other current receipts	65.3	36.8	63.9	58.3	75.5
Total current receipts	1,108.5	1,315.1	1,646.4	1,883.4	2,187.5
Ratios (%)					
Income and profits tax/current receipts	14.6	15.4	14.7	13.4	12.8
Income and profits taxes/GNP	4.6	4.9	5.0	4.6	4.5
Taxes on goods and services/current receipts	23.9	23.6	21.0	21.5	20.2
Taxes on goods and services/GNP	7.5	7.5	7.0	7.3	7.1
Import duties/current receipts	23.8	24.1	26.6	30.2	28.8
Import duties/GNP	7.5	7.6	9.0	10.3	10.2
Oil receipts 2//current receipts	15.6	17.2	19.0	16.4	14.1
Oil receipts 2//GNP	4.9	5.4	6.4	5.6	5.0

Source: Data furnished by the Tunisian authorities.
1/ Includes receipts on all Treasury accounts plus social security receipts.
2/ Production taxes charged on the profits of ETAP (the national oil company), royalty payments and supplemental surtaxes.

Table 2.3

TUNISIA - Economic Classification of the Consolidated Current Expenditure of the Central Government 1/, 1980-84
(Millions of dinars)

	1980	1981	1982	1983 Prelim. figures	1984 Budget
Salaries and wages	326.0	410.7	503.0	597.6	646.2
Goods and other services	145.3	132.8	197.2	236.0	267.5
Interest on debt	50.4	64.7	98.1	116.8	144.1
Subsidies and other transfers	264.4	431.2	490.6	540.7	813.0
Consumer subsidies	( )	(142.6)	(160.0)	(145.0)	(246.0)
Transfers to non-financial Public enterprises	(...)	(13.1)	(31.4)	(35.0)	(145.0)
Transfers to households	(...)	(150.3)	(158.6)	(214.3)	(265.3)
Others	(...)	(125.2)	(140.6)	(146.4)	(156.7)
Others 2/	-5.0	-129.5	-8.7	16.3	20.3
Total current expenditures	784.1	909.9	1,280.2	1,507.4	1,891.1
Ratios (%)					
Salaries and wages/ current expenditure	41.6	45.1	39.3	39.6	34.2
Salaries and wages/GNP	9.2	9.8	10.3	10.8	10.4
Subsidies and other transfers/ current expenditure	34.1	47.4	38.3	35.9	43.0
Subsidies and other transfers/ GNP	7.6	10.3	10.0	9.8	13.1

Source: Data furnished by the Tunisian authorities.

1/ Includes all expenditures on Treasury accounts, off-budget expenditures financed by external aid, and social security expenditures.

2/ Includes unclassified expenditures and also adjustments for differences between commitments and disbursements.

current expenditures is only around 12% against 21.6% in 1984. In particular, subsidies on consumer goods and to the public enterprises are projected to increase only by 15% against 43% in 1984. The recommendations contained in Chapters V and IX concerning interest rate subsidies and the public enterprises could help to reduce budget expenditures on current transfers.

C. Household Savings

2.15 As mentioned in Chapter I, household savings rose from 7.8% of GDP in 1981 to 9.2% in 1984. To be able to interpret this recent rise in household savings propensity, we need to have a fairly precise function of household consumption. Failing such a function we have to be content with qualitative observations. It is necessary to distinguish two aspects of household savings: their amount and their structure. The level of household savings appears, in Tunisia as in most other countries, to conform largely to the Keynesian model since it is largely governed by the evolution of real income. Thus, the recent increase in the global savings and financial savings of households is attributable in large part to the increase in real wages.

2.16 The level of saving is also influenced by other factors: interest rate levels, labor market prospects, and so on. Interest rates appear to have a greater effect on the structure than on the level of private savings. Recent experience confirms the impact of interest rate variations on the share of financial savings in total household savings and on the fraction of private savings mobilized by the financial institutions. Thus, the high rate of growth of time deposits and savings deposits in 1981 (23%, against 14% in 1980 and 10% in 1982) must be compared with the rise in the interest rates scale that took place in April 1981.

Liquidity of the Tunisian economy

2.17 About 40% of household savings is placed in financial assets, of which currency and bank deposits account for a very high proportion. The trend of financial savings of households is consequently closely bound up with the liquidity of the Tunisian economy.

2.18 From 1978 to 1981 nominal GDP grew at more or less the same rate as the monetary aggregates M1 and M2, leaving the liquidity rates $\frac{(M1)}{(GDP)}$ and $\frac{(M2)}{(GDP)}$ more or less constant. This trend was broken in the 1982-83, when the monetary aggregates M1 and M2 grew faster than nominal GDP (i.e. the trend of income-velocity of M1 and M2 was downward). In 1984, the income-velocity of M1 accelerated somewhat and even that of M2 increased slightly.

Table 2.4
RATE OF LIQUIDITY OF THE ECONOMY
(end-of-period monetary aggregates)

	1977	1978	1979	1980	1981	1982	1983	1984
$\frac{M1}{GDP}$	26.2	27.7	26.7	27.1	27.0	28.7	30.3	28.3
$\frac{M2}{GDP}$	39.8	42.2	41.5	41.2	41.7	42.7	44.0	43.5

2.19 Interpreting liquidity rates in an economy in which prices are closely controlled by the public authorities is a difficult task. In terms this context, price control can lead to overvaluing of the liquidity rate of the economy or, what comes to the same thing, undervaluing the income velocity of the currency. Comparison of the various liquidity rate figures over the course of time is meaningful only if the degree of price management by the public authorities remains approximately constant.

2.20 The recent changes in the liquidity rate of the Tunisian economy justify the introduction of a credit ceiling policy (Chapter III) by means of which it can be better controlled. Thus, for example, even if the increase in the liquidity rate does not necessarily entail an immediate acceleration of inflation, it can pave the way for a rise in inflation during subsequent periods consequent on activation by the economic agents of monetary cash balances built up previously.

2.21 On the scale of a partial international comparison, still by no means easy to interpret since concrete delimitation of monetary aggregates and degree of price control can vary from one economy to another, the Tunisian economy is not particularly "liquid." Table 2.5 compares the liquidity rates of certain Mediterranean countries of Africa with those of certain countries of southern Europe.

Table 2.5

COMPARISON OF LIQUIDITY RATES, 1982

	$\frac{M1}{GDP}$	$\frac{M2}{GDP}$
Tunisia	0.29	0.43
Morocco	0.36	0.44
Greece	0.18	0.71
Spain	0.26	0.84
Portugal	0.30	1.08
Italy	0.47	0.79

Source: Data taken from International Financial Statistics, IMF.

2.22 Analysis of the liquidity rate of the Tunisian economy needs to be supplemented by study of the trend of real cash balances. From 1980 to 1983 real cash balances increased beca se the money supply (M2) rose appreciably faster than the retail price index or the GDP deflator.

Table 2.6
TREND OF REAL CASH BALANCES

	1980	1981	1982	1983	1984
Rate of growth of M2	18.6%	19.3%	18.9%	18.5%	11.7%
Rate of growth of GDP deflator	14.5%	11.4%	16.8%	8.4%	7.8%
Rate of growth of retail price index	10.0%	9.0%	13.6%	9.0%	8.4%

2.23 Except in 1983 and 1984, the growth of real cash balances is less sharp when it is evaluated using the GDP deflator, less directly controlled by the public authorities than the retail price index (the cost of living index used to adjust the guaranteed minimum wage). It would a fortiori be reduced if it were referred to an index of inflation in Tunisia that eliminated the effect of price control. It is nevertheless quite clear that there has been a rise in real cash balances. This development can no doubt be linked to the high growth rates of GDP volume in recent years.

2.24 The share of currency in the money supply (M2) furnishes interesting information on the degree of financial development of the Tunisian economy. As in other countries, this share is declining but it is subject to fluctuations which result both from changes in the policy concerning lending interest rates (the ratio falls significantly in 1981 after the rise in interest rates on time deposits and special savings accounts) and from the decrease in time deposits (as in 1982).

Table 2.7

SHARE OF FIDUCIARY MONEY IN M2 (END OF YEAR)

1967	1975	1976	1977	1978	1979	1980	1981	1982	1983
29.9%	24.4%	24.0%	24.4%	23.8%	21.7%	20.7%	19.9%	21.4%	21.9%

2.25 In international comparisons, Tunisia appears as an "intermediate" country between the figures obtained for the developed countries (close to 10%) and those found for the developing countries (around 30%).

Table 2.8

SHARE OF FIDUCIARY MONEY IN M2. INTERNATIONAL COMPARISONS (1982)

Tunisia	Morocco	Senegal	Portugal	Spain	Greece
21.4%	30.0%	32.2%	12.8%	9.2%	16.8%

2.26 The relatively important role of bank money in the Tunisian economy has two major consequences:

(i) It has the advantage of reducing the possible scope of hoarding even if it does not by itself imply any hypothesis concerning the scale of the propensity to hoard the available stock of notes (this propensity can in some cases be high and partly offset the advantage associated with extensive use of bank money).

(ii) It governs the degree of potential dependence of the second-tier banks vis-à-vis the Central Bank in the process of monetary creation. Since the compulsory reserve ratio is at present equal to zero, the theoretical value of the monetary base multiplier calculated for the aggregate banking system is given by the ratio ($\frac{1}{b}$), in which b is the share of currency in the money supply. 1/

1/ For any individual bank (microeconomic approach), the value of the credit multiplier depends also on that bank's market share in the capturing of deposits.

2.27 At the end of 1983 the value of the theoretical monetary base multiplier was about 4.6, whereas the apparent multiplier, calculated by relating the money supply M2 to the monetary base at the same date, is slightly lower (4). Thus, because the compulsory reserve ratio is zero and the value of the ratio $\frac{\text{Currency}}{\text{money supply}}$ is moderate, the theoretical degree of independence of the commercial banks with regard to the Central Bank is higher in Tunisia than in most countries of comparable development level. However, this theoretical degree would become the measure of the real degree of independence of the deposit banks only if the country were to implement a monetary base policy or, more generally, any form of monetary policy implying a causality proceeding from variations in the monetary base toward changes in the money supply.

2.28 The stability of, or even slight increase in, the share of currency in M2 is due to several factors:

(i) The slowdown in the growth -- and even, at certain times, the decline in absolute value -- of time deposits due to the placement policies of institutional investors (social security funds and insurance companies) (see paragraph 5.13).

(ii) The occurrence of threshold phenomena, the use of bank money in the Tunisian economy being high in comparison with other indicators of economic development in Tunisia.

(iii) The rise in the absolute numbers of payment incidents, particularly uncovered checks. This rise, which reduces confidence in bank money, is however considerably reduced, or even disappears, if we relate the number of uncovered checks to the total number of checks presented at the clearing house (this ratio has remained more or less stable over time at close to 1%).

Savings in the form of bank deposits

2.29 The financial statistics published in Tunisia do not permit clear segregation of deposits held by households and those held by non financial enterprises. We can, however, obtain useful information about the trends of household financial savings by analyzing the evolution of deposits with the commercial banks, CENT and CNEL, excluding the demand deposits of the enterprises and the time deposits of the insurance companies and social security agencies. The basic data given in Table 2.9 indicate that cumulative household savings in the form of deposits have risen faster than GDP.

2.30 Assessment of household savings in light of the trend of bank deposits has to be clarified by four points which are analyzed in the following paragraphs:

(i) the proportion of demand deposits in total bank deposits;

(ii) the effect of the deposits of institutional depositors (insurance companies and social security funds) on the trend of time deposits;

(iii) the sensitivity of the money supply trend to remittances by emigrant Tunisian workers;

Table 2.9

Deposits with Banks, CENT and CNEL
(millions of dinars: end-of-year figures)

	1978	1979	1980	1981	1982	1983
Deposit Banks						
1. Demand deposits	381.8	459.7	567.8	667.6	824.6	958.1
2. Households	109.2	129.0	160.9	209.0	251.8	322.2
3. Enterprises	272.6	330.7	406.8	458.6	572.8	635.9
4. Time deposits	215.1	245.1	283.5	331.0	309.9	312.1
5. Institutions	115.1	130.1	152.2	125.1	88.9	49.0
6. Others	100.0	115.0	131.3	205.9	221.0	263.1
7. Savings deposits	110.7	143.6	178.9	238.6	309.8	407.0
CENT and CNEL						
8. Savings deposits	90.2	113.6	130.0	164.3	210.7	248.8
9. CENT 1/	50.2	59.0	67.0	84.1	100.3	120.9
10. CNEL	40.0	54.6	63.0	80.2	110.4	127.9
Total deposits excluding demand deposits of enterprises and time deposits of institutions 2/						
TD millions	410.1	501.2	601.1	817.8	993.3	1241.1
% of GDP	16.5	17.0	17.1	19.8	20.7	22.7

1/ Including foreign exchange savings accounts.

2/ sum of lines (2) + (6) + (7) + (8)

Source: Central Bank of Tunisia: Financial Statistics

(iv) the relative weights, in quasi-money, of time deposits and special savings accounts.

The share of demand deposits in the total deposits of the banking system

2.31 The share of demand deposits in total deposits with the commercial banks, CENT and CNEL rose slightly during the recent period, from nearly 48% at the end of 1978 to 50% at the end of 1983. This recent development stems in large part from the decline in absolute value of time deposits of institutional depositors, partially offset by the growth of special savings accounts.

2.32 The fact that at the present time 57% of bank resources consists of demand deposits, earning interest of 2% a year (demand deposit accounts of individuals) has to be taken into consideration in the context of the proposals relating to the interest rates scale (see paragraphs 5.22 through 5.24).

The influence of institutional deposits on the trend of time deposits

2.33 The growth of quasi-money and therefore of the money supply (M2) is very sensitive to the trend of time deposits by the insurance companies and social security funds. The share of time deposits of the institutional depositors in total time deposits with commercial banks has fallen appreciably since 1980, to only 15.7% at the end of 1983.

Table 2.10

SHARE OF TIME DEPOSITS OF INSTITUTIONAL INVESTORS IN TOTAL TIME DEPOSITS OF COMMERCIAL BANKS (END OF YEAR)

1978	1979	1980	1981	1982	1983
53.5%	53.1%	53.7%	37.8%	28.7%	15.7%

2.34 The decline in time deposits of institutional depositors is explained by the conjunction of several factors:

(i) The growing cash difficulties of the insurance companies and the social security funds. Thus, in the area of social coverage, CAVIS 1/ is in a deficit situation following extension of its field of operation to new population groups, while the liquidity surpluses of the CNSS 2/ are progressively falling for the same reason.

(ii) The diversification of institutional placements. This may be a matter of diversification at the behest of the public authorities: the social security funds have reduced their time deposits with the banks in order to purchase a significant amount of capital equipment bonds. But it may involve diversification spontaneously initiated by the institutional depositors: the same social security funds, particularly the CNSS and the CNRPS, 3/ have strengthened their presence in the low-cost housing sector.

1/ Caisse d'Assurance Vieillesse, Invalidité et Survie.
2/ Caisse Nationale de Sécurité Sociale.
3/ Caisse Nationale de Retraite et de Prévoyance Sociale.

2.35 The rising share of time deposits held by individuals and enterprises, the counterpart to the falling share of institutional depositors, should tend to strengthen the overall elasticity of supply of time deposits to interest rates payable. Thus, the institutions' placement policy results more from the constraints deriving from the regulations or from monetary policy in general, and is hence no doubt less sensitive to interest rate movements than the placement policies of individuals and enterprises.

2.36 The contribution of the insurance companies to the liquidity of the financial system, particularly of the deposit banks, has declined for three main reasons:

(i) The insurance companies are subject to the "bond obligation." A 1979 decree of the Minister of Finance requires that at least 50% of technical reserves be placed in capital equipment bonds. The proportion of these technical reserves invested in certificates of deposit and time deposits with the banks is subject to a ceiling;

(ii) The cash situation of many insurance companies has deteriorated recently owing to the imbalance of certain risks (such as the automobile insurance branch) and the inflexibility of the rating of these risks;

(iii) In the insurance sector, arrears are growing, owing in particular to a sharp rise in the premium arrears of the public enterprises toward the insurance companies.

2.37 The trend in the structure of insurance company placements confirms the significant fall in the proportion of reserves held in the form of time deposits or certificates of deposit.

Table 2.11
STRUCTURE OF INSURANCE COMPANY PLACEMENTS (END OF YEAR)

	1981	1982
Capital Equipment Bonds	41.8%	42.4%
Bonds	8.0%	7.0%
Shares	22.5%	23.0%
Land and buildings	12.9%	17.6%
Time deposits, certificates of deposit, liquidities	14.8%	10.0%

2.38 The existence of arrears helps to explain the gap between the minimum proportion of capital equipment bonds required by the regulations (50%) and the actual proportion held. As in the case of the social security agencies, portfolio restructuring has operated to the detriment of bank deposits and certificates of deposit in the banks and to the benefit of real-estate investments.

Deposits of emigrant workers

2.39 A not inconsiderable share of the monetary components of savings takes the form of deposits of Tunisian workers abroad. The growth of emigrants' remittances is slowing down (see Annex 2) under the combined effect of several factors:

(i) The existence of an interest rate differential between Tunisia and the international capital market which is not offset by the expectation of an appreciation of the dinar. The deposit interest rates paid in Tunisia do not encourage repatriation of foreign exchange.

(ii) The economic recession and the rise in unemployment in the host countries. In this respect Tunisia is experiencing the same problems as other countries substantially dependent on emigrants' remittances (such as Morocco and Portugal).

(iii) The demographics of the emigrant population, particularly its aging and the permanent integration of the younger members into the host countries.

(iv) The maintenance of certain exchange control formalities which have to be complied with in order, for example, to open foreign exchange savings accounts.

2.40 Conscious of the need to slow down the rate of decrease in emigrants' remittances, the monetary authorities have sought to adapt the financial instruments offered to Tunisian workers abroad. The financial services of the Postal Department have played, and continue to play, a fundamental role in this process. Thus, since 1967, CENT (Caisse d'Epargne Nationale Tunisienne) has offered Tunisian workers abroad foreign exchange savings accounts without any ceiling on deposits, paying interest one point higher than that on special savings accounts and exempt from tax. Since 1982 two new formulas have been available to Tunisian workers abroad:

(i) the convertible dinar account offered by all the financial institutions 1/ and currently paying 9% interest, exempt from tax irrespective of duration;

(ii) the convertible foreign exchange account, also on general offer, which is guaranteed an interest rate (exempt from tax) equal to the interest rate paid on deposits of the same nature in the host countries.

2.41 It has to be recognized that the introduction of these new financial instruments for Tunisian workers abroad has so far produced only limited results. Thus, at December 31, 1983, holdings in foreign exchange or convertible dinars represented only 0.4% of the total quasi-money collected by the deposit banks. The lesson to be drawn from this is that financial innovation -- in this case, the introduction of new financial instruments adapted to the needs of Tunisian workers abroad -- while a necessary condition, is not in itself sufficient to reverse the trend observed. It should be supplemented by reduction of the interest rate differential between Tunisia and the international capital markets and by a more active policy of mobilization of emigrant workers' savings. The other aspects of the problem, particularly the demographic dimension and the economic situation in the host countries, are outside the control of the Tunisian authorities.

1/ With the exception of the development banks.

Special savings accounts and time deposits

2.42 The continued success of the special savings accounts is due mainly to two factors:

(i) These accounts are the backbone of small savings mobilization. Thus, CENT holds about 500,000 savings accounts with an average balance per account of about TD 300 (to be compared with the ceiling of TD 5,000 which has remained unchanged since 1965).

(ii) Taking into account tax exemption, the net yield of the special savings accounts is negative or very slightly positive in real terms (interest rate of 7.75% on accounts from 12 to 18 months and 9.75% on accounts at over 2 years) but nevertheless attractive in comparison with other placements of liquid savings. The success of the special savings accounts is such that the prohibition on opening more than one account per person is largely evaded and that, with the information currently available, there are no means of measuring the scope of the phenomenon or of stemming it.

2.43 The attractiveness of the special savings accounts explains their rising share of total time deposits excluding institutional deposits and savings deposits. The following figures show that during recent years this trend has been broken only in 1981. This break is probably explained by changes in the structure of borrowing interest rates that year, which was reflected in increases of 1.5 to 2 points for time deposits and 1.25 to 1.5 points for savings accounts. The data given in Table 2.12 appear to confirm that the interest rate changes have had an appreciable impact on the amount and, particularly, the composition of financial savings.

Table 2.12

SHARE OF SPECIAL SAVINGS ACCOUNTS 1/
(Ratio of SSAs to time deposits + SSAs)
(end-of-year figures)

1978	1979	1980	1981	1982	1983
66.8	69.2	70.2	66.2	70.2	71.3

1/ Excluding insurance company and social security fund deposits.

2.44 Alongside the savings mobilized by the financial institutions, there exists in Tunisia, as in most other developing countries, a significant volume of informal savings which consist essentially of idle cash balances, savings in the form of livestock, holdings of gold, and the savings directly invested in housing. The undeniable success of housing savings in Tunisia and of the CNEL (Caisse Nationale d'Epargne-Logement), which in December 1983 had total housing savings accounts balances of TD 128 billion — has undoubtedly reduced, in comparison to what has happened in other countries, the amount of the informal savings used in the housing sector.

Borrowing interest rate policy

2.45 Interest rates are closely managed, both borrowing rates, for which the monetary authorities set precise levels, and lending rates, which are allowed to fluctuate only within a very narrow predetermined range (in general 0.25 of a point; for a few loan operations, 0.50 of a point). The only notable exception to this rule is long-term interest rates (loans in excess of seven years). The current interest rate structure is very complicated because it combines a very fine differentiation of interest rates by sector of activity (in the case of lending rates) or by type of account (in the case of borrowing rates) with a differentiation according to term.

2.46 Since 1962 the borrowing interest rate structure has been changed nine times (see Annex A.3). The last review took place in April 1985 following the World Bank mission that prepared this report. It resulted in increases averaging 1 point in the interest rates on time deposits, certificates of deposit and special savings accounts. These increases correspond partially to the recommendations of the World Bank mission. However, it would be necessary to increase the average interest-rate level a little more, as proposed in the present report, unless there were clear and solid indications of a substantial drop in the inflation rate (which does not seem very likely).

2.47 The very strict system of exchange controls allows interest rates in Tunisia to be largely independent of international interest rates, at least in terms of level. In terms of dynamics, this independence is perhaps less marked but it does exist. The empirical tests relating to this question are difficult since the structure of lending and borrowing interest rates is changed too infrequently to permit comparison with international capital market rates and because the money market rates, being more volatile (they in fact fluctuate within a limited range, for example between 8.375% and 9% 1/ in the year 1984), are not very significant. These money market rates in fact represent a marginal volume of bank refinancing operations since, being higher than the Central Bank rediscounting rates, they amount for the banks to penalty rates.

2.48 Comparison of the Tunisian money market rates and the London Eurodollar interest rates confirms the absence of a strong and stable link between the two series. Thus, money market rates in Tunisia rose between the first quarter of 1982 and the second quarter of 1983, whereas Eurodollar rates fell during the same period. The reverse happened between the second and third quarters of 1983. Calculation of the correlation coefficient confirms the absence of a link between the two interest rate series: this coefficient, in quarterly averages over the period 1982-83, is only 0.084.

2.49 The exchange control system currently applied by Tunisia means that Tunisian interest rates can be fixed on the basis mainly of domestic considerations, particularly actual and anticipated inflation trends.

1/ 7.75% and 8.875%, respectively, before the last increase.

Table 2.13

TUNISIAN AND INTERNATIONAL INTEREST RATES
(quarterly averages)

	1982				1983			
	I	II	III	IV	I	II	III	IV
Money market rate in Tunisia (minima)	8.25	8.75	8.42	8.125	8.29	8.67	8.46	8.7
Eurodollar rate, 3 months, London	14.87	15.09	12.59	9.91	9.16	9.32	10.08	9.72

2.50 To be able to evaluate accurately the present interest rate structure in real terms we would need to know two discrepancies:

(i) the difference between actual inflation and inflation as measured by the GDP deflator or the retail price index;

(ii) the discrepancy, if any, between actual inflation and inflationary expectations, which must be integrated into the measurements of real interest rates.

2.51 Even though these two discrepancies are not known, it can be stated that borrowing rates in recent years have for the most part been negative. Even following the latest increase (April 1985), most of these rates are still negative in real terms. For example, annual interest on special savings accounts at 6 months to 1 year is 5.5% (net of taxes), whereas the interest rate on time deposits and registered certificates of deposit held by individuals with the same term is 6.03%, taking into account the 11.5% tax on income from credit balances (Impôt sur le Revenu des Créances -- IRC) and the special solidarity levy (Contribution Exceptionnelle de Solidarité -- CES), equal to 20% of the IRC. By contrast, the interest rate on special savings accounts at more than 2 years is 9.75%, while that on time deposits and registered certificates of deposit held by individuals at more than 2 years is only 8.62% after taxes. Comparison of these after-tax interest rates with the inflation rates as measured by the GDP deflator or the retail price index leads to slightly negative or barely positive real rates even for the components of consolidated savings.

Increase in borrowing rates

2.52 The proposed changes in interest rate policy are set forth in broad outline in Chapter IV (para. 4.20 and 4.30). With regard to borrowing rates, it would be desirable to apply slightly positive real rates for placements beyond 6 months. The reasoning presented here is founded on the basic hypothesis -- which would be favorable if we compared it with the figures recorded in the recent past -- of actual inflation and of inflation expectations of around 8% a year. The proposals made here will, of course, have to be adjusted if it turns out that inflation remains durably higher than 8%.

2.53 Despite the increase of around 1 point in borrowing interest rates introduced in April 1985, if inflation remains persistently above 8%, consideration should be given, with the object of stimulating the financial savings of households, to new adjustments of borrowing rate levels:

(i) Interest rates on time deposits and certificates of deposit (whether registered or to bearer) at up to 2 years should rise another 2 points. Thus, time deposits of 1 year to 18 months would carry a nominal rate of 10%, i.e. about 8.6% after taxes. The real yield of this investment would thus be very slightly positive, assuming that inflation remained around 8%.

(ii) Interest rates on time deposits and certificates of deposit at 3 years and over would be freed. This proposal affects a decreasing (since 1978) but still significant proportion of total time deposits managed by the banks. At the end of 1983 about 55% of the time deposits received by the deposit banks had terms of 2 years or more.

Table 2.14

TIME DEPOSITS AT 2 YEARS OR OVER MANAGED BY THE DEPOSIT BANKS
(as % of total time deposits)
(end of year)

1975	1978	1979	1980	1981	1982	1983
60.4%	75.2%	73.8%	72.8%	63.2%	61.8%	55.2%

(iii) Interest rates on special savings accounts would be raised, but by a lower percentage than the time deposit and deposit certificate rates with the object, taking into account the tax effects, of reducing the gap in favor of the special savings accounts for placements at more than 2 years from 1 point to about 0.5 of a point. They would rise by 1.5 points.

(iv) Interest rates on demand deposits would be kept unchanged, i.e. 1% for demand deposits of enterprises and 2% for those of individuals.

(v) The rise in borrowing rates would only partially affect emigrants' deposits in foreign exchange or convertible dinars, which already enjoy interest rate advantages and tax exemptions. Thus, the interest rate on deposits in convertible dinars of Tunisian workers abroad remain at its present level of 10.5%. The interest rates on foreign exchange savings accounts would have to correspond to the interest rates on deposits with similar characteristics and in the same currencies in other countries; they would have to be adjusted fairly frequently (for example, every three months) to reflect changes in the interest rate of each currency.

2.54 The effect of the proposed increases in borrowing interest rates on the aggregate volume of private savings and on the average propensity to save of households is uncertain. It has already been suggested that propensity to save is influenced more by variations in real income than by interest rate movements. On the other hand, the proposed rise in borrowing rates should increase the share of financial savings in total savings and the proportion of household savings mobilized by the financial intermediaries. This would make it possible to reduce low-yield direct investment of informal savings (certain real-estate assets and durable goods) and to raise overall investment efficiency. Moreover, the rise in borrowing interest rates would at least go some way toward slowing down the outflows of capital and the failures to repatriate export receipts that have taken place in spite of exchange control.

2.55 The impact of the proposed measures on the average cost of the banks' resources can be determined only under certain hypotheses. It is possible that some degree of harmonization among the banks will limit the rise in borrowing rates, freed in the case of time deposits at 2 years or more, or bring it into line with the rate for time deposits at less than 2 years. Under this simplifying hypothesis, since demand deposits represent around 60% of total bank money (including quasi-money) and special savings accounts represent about 20% of that total, the recommended increases should, for a given structure of the banks' liabilities, lead to an increase in the average cost of bank resources on the order of 0.5-0.7 of a point.

2.56 The proposed measures will have the effect, in the medium and long term, of modifying the structure of bank resources by increasing the proportion of time deposits and special savings accounts, since their yield to savers will rise in comparison to that of demand deposits. The result of this movement would be to increase the average cost of bank resources a little more. The figure of 0.7 of a point must therefore be regarded, in the medium and long term, as a minimum figure. To estimate the discrepancy between this floor and the actual figure, we would need to know -- which is not the case -- the sensitivity of the term structure of the banks' liabilities with respect to the term structure of borrowing interest rates. In any event, this movement would be gradual and it would therefore take time for the rise in the average cost of bank resources to exceed 1 point.

Measures supplementing the interest rate increases

2.57 It is recommended in Chapter IV that greater flexibility be introduced into lending interest rates in line with the needs of monetary policy. Consequently, borrowing rates would also have to become more flexible. The necessary flexibility would be obtained in part by freeing the interest rates on time deposits and certificates of deposit at 2 years or more, as proposed in paragraph 2.53. It should be possible also to modify the interest rates on the other categories of time deposits and savings accounts without difficulty. It is therefore desirable to introduce a system of basic rates to which deposit interest rates would be tied (except for the freed rates and the rates on demand deposits). As explained in Chapter IV, each of the interest rates to which the system would be applied would be equal to the basic rate plus or less a given margin which would be more stable than the basic rate. To change a particular interest rate under this system it would suffice to change the basic rate.

2.58 In a financial system in which the banks are very reluctant to engage in term "conversion," in particular for fear of the risk of illiquidity, consolidation of bank liabilities is necessary to the growth of medium- and long-term credit. This observation applies perfectly to the case of Tunisia, where economic development presupposes an increase in the share of medium- and long-term loans in total loans made by the deposit banks.

2.59 With the object of reducing the relative cost of time deposits and special savings accounts to the banks and avoiding the latter being provoked into refusing to receive new time deposits, three recommendations are offered:

(i) The restoration of compulsory reserve ratios in excess of zero in order to control the growth of bank liquidity (Chapter III) should be accompanied by marked differentiation according to the nature of the deposits. Consideration could be given to introducing a system of three reserve ratio levels:

- one level for demand deposits;
- another, lower level for special savings accounts and time deposits up to 12 months;
- a third level, even lower and perhaps even zero, for time deposits and special savings accounts of over 12 months and emigrants' deposits regardless of term.

(ii) With the same objective, the ratio of compulsory investment in capital equipment bonds and CNEL bonds should be modulated to make it significantly lower for emigrants' deposits, time deposits and special savings accounts than for demand deposits.

(iii) The policy of placing a ceiling on credit, suggested in Chapter IV, would have to take account of the effort of the banks in mobilizing stable resources. The credit ceiling rules imposed on each bank would be determined in light of the growth of the demand deposits, special savings accounts and time deposits with that particular bank, and of its equity funds, greater weights being accorded to term accounts, emigrants' deposits and equity funds.

2.60 The system of weighting of deposits used in calculating the ceilings for each bank, referred to in the preceding paragraph, could for example be as follows:

(1.0)	for demand deposits and time accounts up to 12 months;
(1.5)	for time accounts of over 12 months;
(2.0)	for emigrants' deposits, regardless of term;
(3.0)	for equity funds.

If this system were to be adopted, the amount l_A^n, in dinars, of the increase in lending authorized for bank A in the course of year n would be derived from the following formula:

$$l_A^n = \frac{1 \times d_V^{n-1} + 1{,}5 \times d_t^{n-1} + 2 \times d_e^{n-1} + 3 \times f^{n-1}}{1 \times D_V^{n-1} + 1{,}5 \times D_T^{n-1} + 2 \times D_E^{n-1} + 3 \times F^{u-1}} \times L_T^n$$

where

- d_V^{n-1}, d_t^{n-1}, d_e^{n-1}, and f^{n-1} represent total deposits at up to 12 months, at more than 12 months, emigrants' deposits and equity funds, respectively, at bank A at the end of the year n-1;
- D_V^{n-1}, D_T^{n-1}, and D_E^{n-1} and F^{n-1} represent total deposits at

up to 12 months, at more than 12 months, emigrants' deposits and equity funds, respectively, held by all the deposit banks at the end of year n-1; and
- L^{R}_{T} represents the total increase in credit authorized by the authorities for all the deposits banks for year n. The weighting structure would have to be stable to some degree over time. It could, however, be changed in the event of serious current balance of payments problems, which would lead the authorities to strengthen the advantages accorded to emigrants' deposits, etc.

2.61 The suggested differentiation of a number of essential instruments of monetary policy (credit ceilings, compulsory reserves, compulsory investment ratios) should make it possible to offset, from the point of view of the banks, the suggested change in the term structure of borrowing interest rates but no doubt also to go beyond simple offsetting by inducing them to consolidate their liabilities and therefore their assets. It should also lead the banks to step up their efforts to collect emigrants' deposits, an essential component at a time when Tunisia is increasingly suffering from external constraints.

2.62 The suggested increase in borrowing rates must be accompanied by changes in the interest rates on and the taxation of financial market placements (Chapter IX). Promotion of the financial market calls for the securing and maintenance of an after-tax yield differential sufficient to compensate for the financial market risks (risks of capital losses if interest rates rise for the liquid segments of the market, risks of illiquidity for the other segments, and so on).

<u>The place of housing savings in the mobilization of household savings</u>

2.63 In the area of housing savings, a very delicate one for most developing countries, Tunisia has registered impressive success since 1973-74, with a very sharp rise in the funds captured by CNEL. From December 1975 to December 1983, total balances on housing savings accounts rose from TD 4.4 billion to TD 128 billion. The growth of housing savings was irregular over the period 1976-83: from an original very high level (+224% from December 1975 to December 1976), the growth rate declined appreciably from 1976 to 1980 and then rose again between 1980 and 1982 (+38% in 1982). During the recent period, the growth of funds collected by CNEL (16% in 1983 and 15% in 1984) was much slower. Despite the fact that there was also a slowdown in the growth of other deposits, this is certainly a sign that the housing savings system is "running out of steam" to some extent; the causes of this development need to be analyzed more closely.

2.64 It is interesting to compare the respective market shares of CNEL and CENT, in the medium and long term, in the mobilization of private savings. From 1975 to 1983 total savings balances with CENT rose fourfold, whereas savings with CNEL rose, in nominal terms, by a factor of 30. At the end of 1984, CNEL was mobilizing a larger volume of savings than CENT.

2.65 Some of the reasons for the success of housing savings in Tunisia exist also in most other developing countries; others stem from the specific characteristics of the system installed by the Tunisian authorities.

2.66 The Tunisian saver, like savers in most other developing countries, has a predilection for investment in housing and access to ownership. The housing savings system has made it possible to channel part of the informal savings that were invested directly by the agents in the housing sector back into formal savings. The success of housing saving is due mainly to the attractiveness to the Tunisian saver of the earmarked savings accounts. This attractiveness is the justification for introducing new earmarked savings instruments which supplement the housing savings formula without claiming to equal its success.

2.67 The housing savings instrument offered to the Tunisian saver is moreover quite attractive: a deposit interest rate of 6% or 7% a year (including the bonus paid by the State), depending on whether the account is opened in dinars or in foreign currency; a contractual commitment to grant a loan at the end of 4 or 5 years, depending on the case; a "multiplier" (ratio between the loan granted and the amount saved, including capitalized interest) equal to 2 and sometimes higher. In addition, many savers are attracted by the flexibility of the proposed formula since they can obtain a loan, on less advantageous terms of course, before the end of the contractual period.

2.68 The Tunisian housing savings system has in fact been experiencing a serious crisis since 1983. This crisis differs in its causes from the crises in comparable countries. For example, in some cases the housing savings system has failed because of financial disequilibria inherent in the system installed (excessively high "multipliers," poor evaluation of the time profile of the loans granted and of the deposits made, and so on). In Tunisia the difficulties stem from a bottleneck on the serviced sites and new construction market and thus from a poor match between the "physical market" and the amount of finance available. Because of the scarcity of newly-built housing, savers cannot today use the loans to which there are contractually entitled. Of the 128,000 housing savings contracts in force, 26,000 have exceeded the period of four years. Because of the new construction bottleneck, CNEL finds itself both possessing excessive liquidity -- it is becoming a "potential structural lender" -- and unable to satisfy the credit demand of its clients. CNEL is in a way a victim of its own success.

2.69 The present situation of housing savings is disturbing, since with the de facto breach of the contractual commitment and the lengthening of the queue of savers, confidence in the system is likely to diminish rapidly. Such a trend would bring about a decline in housing savings in Tunisia that would be difficult to reverse. To avoid the flight of savers aware that the likelihood of obtaining a loan is growing increasingly small, a number of measures need to be taken rapidly (some of which were developed by the work of the Inter-Ministerial Commission on Housing Savings that met in 1983):

(i) CNEL should diversify its upstream placements by granting loans to site developers and thereby removing certain constraints on the new construction market.

(ii) Clients should be able to use housing savings to obtain loans for the purchase of sites and the renovation and maintenance of existing dwellings.

(iii) A client who is unable to use the contract loan by the end of the period fixed should receive the highest interest rate applicable to time deposits on his housing savings account.

2.70 At present the deposit banks also offer savers a facility known as "housing savings" but differing significantly from the true housing savings received by CNEL in that there is no contractual commitment by the bank to grant the loan. The de facto blockage of the true housing savings system tends, however, to induce a similarity in some ways between the financial facility of the banks and that offered by CNEL. In the area of housing finance, the banks offer "status loans" (crédits-standing) for high-income borrowers which differ from the housing savings collected by CNEL in many ways (loan term, interest rate, personal contribution required, and so). The "status loans" do not belong to the category of earmarked contractual savings. But the de facto blockage of CNEL tends to confer on housing savings in the strict sense the same "non contractual" dimension as status loans.

Financial instruments offered to savers

2.71 The Tunisian financial system is, in the analytical sense, "over-determined" by the monetary authorities, who control both the money supply (through a regulatory procedure which, as indicated in Chapter IV, is poorly adapted to overall control) and interest rates. In addition, the monetary authorities exercise close surveillance over the introduction of new financing facilities. In Tunisia, financial innovation is principally public, i.e. is introduced by the public authorities, and financial innovation at the initiative of the deposit banks ("private" innovation) plays a secondary role.

2.72 The new financial facilities introduced by the public authorities since 1981 have three features in common:

(i) They correspond to earmarked savings formulas, so dear to the eyes of the Tunisian saver.

(ii) They owe their attractiveness and their originality to the tax advantages they enjoy; this indicates that public financial innovation, in Tunisia as in other countries, has an essential fiscal content and that it swells the total volume of tax benefits (i.e. of "tax expenditures").

(iii) They are offered by all the financial institutions (by the deposit banks, often also by CENT and the authorized financial establishments).

2.73 The major tax incentive to saving consists of Law 62-75 of December 1962, which has since been amended many times. Under this law, profits or other income reinvested in real assets (construction or extension of buildings or of industrial, agricultural or commercial plant) or in financial assets (shares and bonds) are deductible from taxable income at the rate of 30% of annual taxable income in the case of individuals subject to the State Personal Contribution (Contribution Personnelle d'Etat -- CPE) and 50% in the case of juridical persons (subject, to the tax on industrial and commercial profits, the tax on non commercial profits, etc.). The three financial instruments introduced since 1982 incorporate this general provision into various earmarked savings formulas:

(i) The employment savings (épargne-emploi) accounts opened at deposit banks or other authorized financial establishments serve to build up the self-financing required for the execution of small projects (TD 10,000-20,000) that fall within Tunisia's employment development policy.

(ii) The project promotion savings (épargne-projet) accounts, which are restricted to individuals, are intended to earmark funds intended for the financing of approved projects or projects eligible for assistance by the FNPAPM (Fonds National de la Promotion de l'Artisanat et des Petits Métiers), approved by the API (Agence de Promotion des Investissements), by the APIA (Agence de Promotion des Investissements Agricoles), etc.

(iii) The investment savings (épargne-investissement) accounts, which are open to both individuals and juridical persons, are used to acquire securities of approved companies which must be blocked for five years in order to qualify for the tax benefits.

In 1985 the authorities started to consider the introduction of a system of study savings (épargne-études) accounts. Under this system, savers will have the chance to obtain loans in an amount equal to double that of their accumulated savings, for use in the financing of study expenditures by designated beneficiaries.

2.74 It is still too early to assess the impact of public financial innovation in Tunisia during the recent period, since several of the earmarked-savings formulas have not been implemented until recently. The most complete information relates to employment savings accounts opened since the end of 1982. As of June 1983, 104 employment savings contracts had been signed (nearly 50% of them with two banks, the STP and the BIAT).

2.75 There are no doubt advantages in linking the benefits of Law 62-75 to earmarked savings formulas in order to promote small and medium-sized projects and development of the stock market. Nevertheless, it would be difficult to go any further in this direction, for three reasons:

(i) Increasing the number of earmarked savings formulas would have the disadvantage of fragmenting the financial system and reducing its efficiency.

(ii) In a period when it is necessary to sustain public savings it is desirable to limit "fiscal expenditures" in the form of the tax advantages accorded to savings. It is not a matter of reconsidering the advantages associated with Law 62-75 but of keeping close control over the total magnitude of the losses of taxable revenue.

(iii) The public financing innovations introduced since 1982 are particularly attractive to taxpayers subject to the CPE, the patente or any other form of direct taxation. They are thus addressed at persons with medium or high incomes but hardly to small savers. The range of available financial instruments should no doubt be supplemented by a new savings instrument reserved to individuals not liable to the CPE or with taxable incomes not exceeding a predetermined amount.

2.74 Financial innovation at the initiative of the deposit banks, the main component of "private" financial innovation, is poorly developed in Tunisia because of the close supervision exercised by the monetary authorities and the de facto limits placed on competition between banks. Of particular interest among recent financial innovations are formulas combining deposit at a bank with life insurance (such as the "El Amen" facility offered since 1981 by Crédit Foncier et Commercial de Tunisie, which has promoted it through a vast advertising campaign). Because of the increasing number of uncovered checks and the decline in confidence in payment by check, a number of banks are currently studying the possibility of introducing a system of gasoline checks (chèques-essence).

2.77 Certain development banks and the offshore banks have played an important role in the introduction of new financing techniques in Tunisia. They can be expected to continue to perform this role and to serve as vehicles for the dissemination in Tunisia of financial innovations that have appeared in other financial systems or on the international capital markets. However, the monetary authorities retain substantive control of the pace and form of financial innovation.

2.78 The policy on financial instruments in Tunisia could, in the short or medium term, be constructed around the following principles:

(i) Adaptation of housing savings (section E of this chapter).

(ii) Promotion of the three types of earmarked savings accounts introduced since 1982 (employment savings, project savings, and investment savings); however, no new instruments of this kind should be created, to avoid fragmenting the financial system or excessively reducing the direct taxation base.

(iii) Introduction, following more thorough study, of a financial instrument similar to the special savings accounts, to be offered by CENT and, if they were interested, also by the deposit banks, but, unlike the special savings accounts, reserved to individuals with taxable incomes below a predetermined amount (either they would not have to pay the CPE or its amount would be limited to a maximum set by the monetary authorities). Since the tax advantages associated with this instrument would by definition be zero or negligible, its pretax yield would need to be higher than that at present offered on special savings accounts, time deposits or certificates of deposit. Part of the remuneration of this new financial instrument intended for low-income individuals could derive, exceptionally, from partial or total indexing of the capital to the price index.

The policy of the banks with regard to the receiving of deposits

2.79 The phenomenon of "exclusion" of savers through the minimum balance requirements imposed by the banks on demand and time accounts exists in Tunisia but is less developed there than in the other countries of comparable development (Morocco, Ivory Coast, etc.). In theory, any demand, time or savings account can be opened with 1 dinar. In practice, the deposit banks avoid inflating their costs by accepting small deposits and frequently impose a minimum of TD 200-300 to open an account. In doing this they leave the major role in mobilizing small deposits to the Postal Service (postal checking accounts and CENT).

2.80 The new earmarked savings accounts (project savings, employment savings, and investment savings) all require a minimum of TD 20 to open the account and for every debit or credit transaction; this seems reasonable in view of the specific nature of these accounts. Care should be taken to ensure that the scope of "exclusion" of savers through the policy concerning the opening of accounts remains limited in the future, as it is today.

2.81 Savings can also be "excluded" in another way: the ceiling on special savings accounts opened with the deposit banks or CENT. This ceiling, which has been TD 5,000 since 1965, in practice leads certain savers to disregard the regulations and to open accounts with several financial institutions. This applies in particular to clients of deposit banks, in which the average balance on special savings accounts is TD 3,000. The ceiling was very high when it was set in 1965 and it remains fairly high today in comparison with the average individual wage. Rather than increase the ceiling on special savings accounts, which would favor high-income savers, it would be preferable to introduce a type of savings account specially tailored to low-income savers.

2.82 Mention must be made of a tax provision which penalizes small cash payments into the banks. There is a stamp duty on cash payments (but not on withdrawals) of TD 0.05 regardless of amount. Independently of the policy of the deposit banks, this rule can discourage the depositing of cash sums hoarded by the poorer classes. Even if it has the advantage of strengthening the use of checks and bank money in the economy, it should undoubtedly be abolished.

2.83 The policy of establishing new bank windows, introduced by the Central Bank of Tunisia by means of a basic circular of 1979, is based on a principle that the Central Bank should not retreat from but should rather strengthen. It makes the opening of new bank windows in areas that already possess banking facilities conditional on the establishment of windows in areas where bank facilities are inadequate or nonexistent. According to the 1979 circular, "the Central Bank of Tunisia shall not give its agreement in principle to the annual program of opening of branches (by each bank) unless the program provides for the opening of at least one branch or office in a locality where banking facilities are totally lacking ...". The proportion currently applied is as follows: for an annual program comprising a maximum of five new openings, at least one window must be located in a region that lacks banking facilities.

2.84 For lack of precise information on bank windows opened for specific periods, we have to study the trend in number of permanent windows.

Table 2.15

Number of permanent bank windows (deposit banks)
(end of year, unless otherwise indicated)

1981	1982	1983	May 1984
273	284	301	310

Between 1981 and 1983 the number of bank windows grew at an average rate of 5.0% a year, i.e. about double the population growth and higher than average volume growth of GDP. The 310 permanent bank windows in May 1984 were distributed unequally among the deposit banks in operation.

2.85 An international comparison indicates that the proportion of bank facilities in the Tunisian economy is apparently satisfactory.

Table 2.16

Number of inhabitants per permanent bank window (1982)

Tunisia	Ivory Coast	Morocco
23,600	40,600	32,260

2.86 Other consideration~ suggest that the Tunisian economy is under-provided with banking facilities:

(i) When new bank windows are opened, the "net savings contribution effect" prevails over the "transfer from other placements" effect. The establishment of new bank windows may thus favorably affect the average propensity to save of households and undoubtedly influences the share of such savings mobilized by the financial institutions.

(ii) The bank windows are concentrated in a few banks: in May 1984 the three "large" banks -- Banque Nationale de Tunisie (BNT), Société Tunisienne de Banque (STB) and Banque du Sud (BS) -- accounted for 57% of the number of bank windows, whereas the Banque Franco-Tunisienne (BFT) had only one branch (in Tunis) and the Arab-Tunisian Bank (ATB) three branches, two of them in Tunis.

(iii) The 1979 circular has not been in effect long enough to have corrected the spatial concentration of new bank branches, particularly on the coast. Mention must, however, be made of the effort of the BNT, the leading bank in the mobilization of rural savings, to disperse its new branches across the country.

2.87 In order to speed up the opening of new bank windows, particularly in areas that lack banking facilities, the constraint measures based on the 1979 circular referred to in paragraph 2.83 need to be accompanied by incentive measures. Since the "breakeven point" on windows established in underprivileged areas is not as a rule reached until they have been in operation for two or three years, it would be useful to link temporary tax advantages to the opening of new branches in under-served areas, such as accelerated depreciation of capital expenditure.

2.88 The mobilization of rural savings calls for an active policy of establishment of new bank branches and suitable organization of the agricultural credit agencies. At the present time rural savings are collected chiefly through two networks, the financial services of the Post Office and the BNT. The BNT moreover effects a net redistribution of resources favorable to the agricultural sector, raising 10% of its resources in that sector but channeling 30% of its placements to it.

Chapter III

BANKING SYSTEM INSTITUTIONS

A. The Structure of the Tunisian Financial System

3.01 Tunisia's financial system is well developed and fairly diversified. At the beginning of 1985 it comprised:

- the Central Bank,
- ten deposit banks,
- nine investment banks,
- two specialized savings institutions,
- one leasing company,
- seven offshore banks.

In addition to these major institutions there are the Postal Checking Center, six portfolio management agencies, six agency offices of foreign banks, and the stock exchange.

3.02 At the end of 1984 the assets of the Central Bank were equal to nearly half the total assets of the deposit banks and exceeded by about 80% the consolidated assets of the investment banks and other financial institutions. These figures reflect, essentially, the relative importance of Central Bank loans to the Government and the other banks and of its international reserves. However, the role of the Central Bank in the Tunisian financial system has to be evaluated in light also of its very extensive powers of regulation of banking operations and prior approval of loans, factors not reflected in its balance sheet.

3.03 The deposit banks are the main source of domestic loans. In spite of certain constraints, the deposit banks can be regarded as true full-service banks: they receive deposits of all types; grant a substantial volume of medium- and long-term loans (about 30% of their total credit to the economy); absorb nearly half the total refinancing facilities of the Central Bank; effect operations in special resources supplied by the Government or raised abroad; are the almost exclusive intermediaries in exchange operations with the exterior; hold a large portfolio of capital participations in enterprises; control portfolio management companies, and are the only intermediaries in stock exchange operations. In recent years, with the creation of new development banks, the deposit banks' share in financing the Tunisian economy has declined slightly: the total amount of their outstanding credit balances on the Government, assistance to the economy and securities portfolios was 4.0 times that of the other financial establishments at the end of 1980 and 3.3 times at the end of 1983. However, this trend is unlikely to be maintained in the next few years. The new investment banks will not continue to have the same scope for rapid expansion after using up their substantial initial capital injections, which have been the major financial base of their recent operations.

3.04 The investment banks group comprises: the Banque de Développement Economique de Tunisie (BDET), the oldest of the development banks, which has played an important role in investment financing, particularly in the industrial sector, including the SMEs; the Banque Nationale de Développement Touristique (BNDT), converted from the former Compagnie Financière du Tourisme (COFIT), which concentrates on hotel loans and other tourism-sector loans and participations; the Banque Nationale du Développement Agricole (BNDA), established recently for the purpose of financing mainly large agricultural investments and agroindustrial projects; and five mixed banks, with equal capital participation by the Tunisian Government and another Arab country: Société Tuniso-Saoudienne d'Investissement et de Développement (STUSID), Banque Tuniso-Koweitienne de Développement (BTDK), Banque Tuniso-Qatarienne d'Investissement (BTQI), Banque de Tunisie et des Emirats d'Investissement (BTEI), Banque de Coopération du Maghreb Arabe (BCMA), and Banque Arabe Tuniso-Libyenne de Développement et de Commerce (BTLD).

3.05 The savings institutions are the Caisse d'Epargne Nationale Tunisienne (CENT) and the Caisse Nationale d'Epargne-Logement (CNEL).

3.06 The main problems of the financial system concern: (i) the resources of the various types of banking institutions, and (ii) banking specialization, competition, and the establishment of new banks. These points are dealt with in the following sections.

B. Resources of the Banking Institutions

Structure of deposit-bank and investment-bank resources

3.07 The deposit banks are in a distinctly more favorable situation than the development banks in the raising of resources. About two-thirds of the total resources of the deposit banks comes from demand, time and savings account deposits. Moreover, the deposit banks enjoy Central Bank rediscounting and advance facilities up to a limit of 17.5% of their aggregate deposits (see Chapter IV). They also have access, as do the development banks, to special resources of the Government, or resources raised abroad by the Government, to finance certain types of selective credits. The special resources, utilized mainly by the National Bank of Tunisia to finance agricultural loans, were equal at the end of 1983 to 9.3% of the total assets of the deposit banks. The equity funds of the deposit banks financed only 6.5% of their total assets (see Table 3.1, which does not however give a complete picture since it does not include the resources corresponding to paper rediscounted by the Central Bank).

3.08 As a counterpart to their right to receive deposits, the commercial banks are subject to certain constraints. For example, they are required to place 25% of their deposits in public securities (including CNEL certificates) at interest rates below those Bank loans. In spite of these constraints, the investment banks generally enjoy distinctly less favorable conditions than the deposit banks as regards raising and average cost of resources. The investment banks are not allowed to accept deposits (except, within very narrow limits, for accounts used by their clients) and do not have access to Central Bank refinancing (except for limited rediscounting facilities in favor of BDET). They finance their operations mainly from (i) equity funds; (ii) the issue of obligations; and (iii) special resources furnished or raised abroad by the Government.

Table 3.1
RESOURCE STRUCTURE OF DEPOSIT BANKS
(End-of-year figures)

	1980	1981	1982	1983	1984	1980	1981	1982	1983
	--- (millions of dinars) ---					------(percentages)------			
Deposits	1,114	1,338	1,557	1,826	2,054	68.9	65.7	63.8	61.0
monetary	(619)	(729)	(886)	(1,050)	(1,107)	(38.3)	(35.8)	(36.3)	(35.3)
quasi-monetary	(495)	(609)	(671)	(776)	(947)	(30.6)	(29.9)	(27.5)	(26.1)
External commitments	77	98	120	159	191	4.8	4.8	4.9	5.4
Advances by the Central Bank	17	65	107	192		1.0	3.2	4.4	6.4
Special resources	184	215	242	276	333	11.4	10.6	9.9	9.3
Equity funds	96	134	254	192	228	5.9	6.6	6.5	6.5
Others	127	186	254	327		7.9	9.1	10.4	11.0
TOTAL	1,616	2,036	2,438	2,971		100.0	100.0	100.0	100.0

Source: Central Bank of Tunisia: Financial Statistics.

3.09 Equity funds are particularly important in the case of the development banks established during the last few years with the participation of Arab capital. Two of these banks have capital of TD 100 million and three have capital of TD 70 million, TD 50 million and TD 40 million, respectively. These Banks have financed their participations and their medium- and long-term loans essentially from their capital, which in several cases has not yet been fully paid up. In the coming years it will be more difficult to use the resources supplied by equity funds, unless these funds are increased substantially. The development banks will therefore have to seek other funds to finance their operations.

3.10 Up to now issues of obligations have been made primarily by the BDET. Recently, STUSID also made an issue of zero-coupon bonds offering substantial tax advantages and an attractive interest rate. However, bond issues by the development banks have so far remained modest and their market is estimated to be quite small. During the two years 1982 and 1983 issues of obligations by the BDET totalled only TD 4.3 million, of which nearly 30% was subscribed by insurance companies (see Chapter X and Table 10.2).

3.11 The special resources are of two kinds: government loans for use in selective credits, and external loans (loans by the World Bank, the European Investment Bank, etc.).

Financial requirements of the development banks in the next few years

3.12 Whereas disbursements by the development banks totalled about TD 200 million in the period 1979-83, the forecasts of the six industrial development banks (BDET, BTKD, STUSID, BTQI, BTEI and BCMA) estimate disbursements at about TD 1,000 million and commitments at TD 1,200 million for the period 1984-88. In comparison with these financing volumes, investment in manufacturing, agriculture and tourism could rise from TD 2.1 billion (1979-83) to TD 4.0 billion (1984-88). The development banks would thus supply 25% of investment financing needs in the period 1984-88 (compared with 10% in 1979-83).

3.13 The creation of the new development banks has substantially improved (by 2-1/2 times) the supply of investment funds in relation to demand. However, realization of the financial forecasts of the development banks will depend on a number of important factors. First of all, the Government, which was responsible for more than 55% of investment in the sectors that constitute the sphere of operation of the development banks, should -- as is the intention -- gradually reduce its role in the productive sectors. Subsequently, the development banks, in taking over from the Government, must actively promote new projects with positive financial and economic rates of return.

3.14 On the basis of the disbursement and commitment forecasts referred to in paragraph 3.12, the financing needs of the development banks during the period 1984-89 should be about TD 800 million (Table 3.2):

Table 3.2

COMMITMENTS AND RESOURCE NEEDS OF THE DEVELOPMENT BANKS, 1984-88
(millions of dinars)

Bank	Annual commitments	5-year commitments	Resource needs
BDET	40	200	170
BTKD	60	300	250
STUSID	55	275	200
BTQI	25	125	50
BTEI	20	100	50
BNDT	25	125	80
BCMA	20	100	--
Total	245	1,225	800

These forecasts take into account the available resources at December 31, 1983, undisbursed commitments at that date, resources to be received (subscribed capital payments, borrowings committed but not yet disbursed) and reasonable cash flows (repayments against loans made and received).

3.15 Although the amounts of the forecasts are large in aggregate they do not appear to be unrealistic in relation to total planned investment and the levels of equity funds (TD 350 million) which determine the institutions' borrowing capacities (about TD 1,500 million). For the forecasts to be realized it will be necessary to devise a strategy for raising the resources required by the development banks either on the local market or on the international market.

Raising of resources by development banks on the local market

3.16 Because of the small size of the local financial market, the possibilities it offers the development banks to raise resources are very limited. It will nevertheless be important to develop these possibilities, with the following objects:

(i) to contribute to development of the capital market;

(ii) to reduce the development banks' dependence on international-market resources, the only major alternative to domestic resources; access to the international capital market does not offer adequate assurance of stability because of its vulnerability to the effects of cyclical changes in the domestic or world economic situation and to political factors;

(iii) to hold the cost of the development banks' resources within tolerable limits; under present circumstances, with exchange and interest rate control, domestic market resources are less expensive than those obtained on the world market, particularly if the exchange risk is not covered by the Government; the development banks would have even greater difficulty in competing with the deposit banks if they had no access to domestic market resources;

(iv) to place the development banks in a better position to replace the Government in the financing of a number of public enterprises; if the Government relinquishes part of the responsibility for financing the public enterprises, at least part of the resources at present used by the Treasury for that purpose should be transferred to the development banks in step with the Government's withdrawal.

3.17 In principle, a number of ways of increasing domestic financial resource mobilization by the development banks come into consideration: (a) access to deposits; (b) Government loans; (c) Central Bank refinancing; (d) issue of obligations, and (e) increase in equity funds through the issue of shares.

3.18 Deposits. In many countries, development banks can receive time deposits. This solution would not be advisable in the case of the Tunisian development banks, particularly because none of them possesses the network of branches that would be necessary to handle contacts with depositors. It would be an unnecessary waste of funds for the development banks to set up a network of branches. The possibility could, however, be considered of authorizing the development banks to issue one- and two-year certificates of deposit (bons de caisse) with the same interest rates and tax treatment as time deposits with the same term. The bonds would be sold over the counters of the development banks and by other financial intermediaries to which they would assign this task. Such an issue would (i) contribute to development of the capital market; (ii) increase the diversity of financial instruments offered to savers and thereby stimulate savings; (iii) increase competition within the banking system, and (iv) reduce the competitive disadvantage that the development banks suffer in relation to the deposit banks.

3.19 Government loans. The Government and the government funds already grant loans out of special resources to the development banks to finance certain specific types of credit operations (agriculture, tourism, small enterprises, etc.). As mentioned above, if the Government relinquishes part of the responsibility for financing the public enterprises and that responsibility is transferred to the development banks, part of the corresponding financial resources should also be transferred to them. The current outlook does not suggest that any substantial transfer of budget resources will be possible, but part of the Treasury funds raised by the issue of capital equipment bonds could be recycled in favor of the development banks. Subscription of these bonds by the deposit banks is the counterpart to the advantageous situation they enjoy in the raising of deposits, particularly demand deposits, which have a very low cost. Better balance would be introduced into competition between the deposit banks and the investment banks if part of the funds mobilized by these capital equipment bonds were made available to the investment banks. The proposed transfers could constitute an additional instrument of selective credit policy, in that the authorities could require that the funds lent by the Government be used only in specific preferential operations. Government loans to the development banks could be made at interest rates slightly higher than those paid on the capital equipment bonds. The level of these rates would depend on the lending rates and intermediation margin set for the development banks. Government loans and Central Bank refinancing could bring the development banks' average cost of resources below that of foreign loans.

3.20 Central Bank refinancing. The Central Bank already grants limited refinancing facilities to BDET. The other investment banks do not have access to this refinancing, which may well be explained by the fact that up to now their equity capital or government and foreign loans have provided them with sufficient resources. However, this situation of abundant resources is likely to change radically in the years to come. It would be difficult to extend resource financing in any substantial proportion to all the investment banks, whether because of the long duration of most of their operations or of the need to avoid increases in aggregate Central Bank refinancing, which could run counter to monetary policy. In spite of this, it would be advantageous to consider reformulating the Central Bank's refinancing policy with two aims in mind: (i) to provide the development banks with better facilities for rediscounting medium-term loans, which can already be rediscounted under certain conditions in favor of the deposit banks, and (ii) to bring about a more balanced distribution of total Central Bank refinancing between development banks and deposit banks.

3.21 Issue of bonds. As stated in paragraph 3.10, the Tunisian market is not at present able to absorb substantial amounts of bond issues. Development of this market will, however, have to be one of the priorities of Tunisia's financial sector policy. In addition to the issue of certificates of deposit as recommended in paragraph 3.18, the development of bond issue operations by the development banks could probably make a very useful contribution to the capital market. The Tunisian authorities and the development banks have been showing a serious interest with regard to the possibilities that could arise in this area. Recently, there has been proof of great flexibility in the choice of the terms and other characteristics of the obligations offered for public subscription: interest rates sufficiently competitive with the return on other financial instruments; a wide variety of redemption terms; obligations with variable interest rates, and obligations convertible into capital or participating in the profits of the issuing banks.

3.22 Increases in equity funds through share issues. If the development banks turned out to be sufficiently profitable in the next few years, they could raise equity funds by offering shares for public subscription. However, the scope for such issues will probably be restricted. Another way of mobilizing equity funds would be to seek additional contributions from foreign partners who exhibited interest in participating in the development of the Tunisian economy. These contributions should, however, be geared to increasing the capital of existing institutions rather than establishing new ones. Since the number of development banks in Tunisia is already very high, it is more important to strengthen the financial structure of those already in existence than to create new similar institutions.

International market resources and government guarantee

3.23 In view of the large volume of funds to be raised, a substantial portion of the development banks' resources will probably come from the international financial market. Up to now the Government has guaranteed all loans obtained by BDET and BNDT, including the two Euromarket loans. The Government has also borne the exchange risk on all borrowings by these two institutions. The other development banks have not yet borrowed but it will be necessary to formulate a policy for them with respect to these two aspects, the Government's guarantee and the exchange risk.

3.24 Since the equity funds of the new development banks are high and their debt levels low, they would very probably succeed in borrowing on the international market, on fairly favorable terms, without the backing of the Government's guarantee. Recourse to that guarantee should therefore be avoided; the Government should guarantee external borrowings by the development banks only in exceptional cases, and then only when the interest rate differential between guaranteed and nonguaranteed loans is comparatively large. It also has to be borne in mind that once a precedent has been established all private lenders will demand the Government's guarantee for any given bank.

Exchange-risk coverage for foreign-exchange loans

3.25 In principle, the exchange risk in foreign loans can be assumed by the banks that obtain the loan, by their clients who use the resources raised, or by the Government. Assumption of the exchange risk by the bank itself for term responsibilities should be avoided unless it can be covered by operations on the term foreign exchange market. The exchange risk is difficult to assess and depends in large measure on the policy applied by the Government to the exchange rate of the dinar. For similar reasons it would be difficult to allow the exchange risk to be borne by the final borrower.

3.26 With a controlled exchange rate which does not always reflect the trend of inflation and productivity differentials between Tunisia and the outside world or of the balance of payments, there is always the risk of sudden changes in the rate which cannot be foreseen very far in advance. These risks could become catastrophic for the final borrower, except in principle in the case of enterprises that export a high proportion of their production. Enterprises operating largely on the domestic market are generally unable to pass on sufficiently quickly, and in their entirety, the effects of exchange rate adjustments on their liabilities and on their costs. They risk being pushed into bankruptcy if a sizable proportion of their debts are denominated in foreign currency and if they are not protected against foreign exchange risks. This is particularly true of SMEs and farming operations relying on financing extended by international institutions to Tunisian banks. In these circumstances, the exchange risk must be assumed by the Government. Moreover, the more the Government is responsible for the exchange rate and for managing of the value of the local currency in relation to the values of foreign currencies, the more reasonable it becomes that the Government assume the related risks.

3.27 In Tunisia the Government has in the past always borne the exchange risk on foreign loans of BDET and BNDT. Until 1981 this coverage gave rise to gains because the dinar was rising against the basket of currencies. Since then the situation has reversed, owing in particular to the substantial appreciation of the dollar. Over a period of ten years the result has always netted out in favor of the Government, but in very recent years considerable losses (TD 15 - 20 million) have been recorded. To offset these losses, in early 1985 the authorities introduced an exchange guarantee commission of 0.5% on bank overdrafts. The proceeds of this commission are paid into the Treasury, which uses them to balance the financial situation of the Exchange Rate Guarantee Fund.

3.28 In a number of countries, the Government provides a guarantee against exchange risks in return for a fixed commission, which may amount to one or two percentage points, for example. This solution usually produces very unfavorable results. For the final borrower, it creates a differential between the cost of financing obtained overseas and that obtained locally. In countries with high inflation rates where nominal interest rates must also be high, the interest rate charged on external borrowings becomes artificially low. In addition, the final borrower will in principle prefer loans in strong currencies, since these carry lower interest rates than loans in soft currencies, even though they also entail much higher exchange risks. The Government or the Central Bank will thus incur substantial losses from this exchange-risk guarantee. In some countries, the financing of these losses has led to expansion of the money supply, with adverse effects on the country's macroeconomic equilibrium. It should also be noted that when foreign-exchange loans carry a strong subsidy element as a result of the exchange-risk guarantee system there is a danger of inequalities among credit users and distortions in the allocation of resources.

3.29 More balanced solutions to the exchange-risk problem can, however, be found. These solution fall into two basic types. In cases where the Government borrows directly abroad and passes the proceeds on to the development banks, it can assume the exchange risk itself and set a single interest rate for loans in dinars financed out of foreign-currency borrowing. By adopting this solution, the authorities could reduce their total exchange risk by diversifying the currencies in which they borrow: exchange losses on hard-currency borrowings would in principle be offset in part by gains (or smaller losses) on soft-currency borrowings. In combination with a borrowing program suitably spread over a number of currencies, the single interest rate would substantially reduce the total exchange risk on individual loans. Thus, the expensive, low-risk loans would be on-lent at a lower margin, while the low-rate loans, in strong currencies, would be on-lent at a higher margin. The on-lending interest rate could be set every six months in light of the actual cost of the outstanding loan portfolio, including exchange losses (or gains), except where these are excessively high (as a result of a major adjustment in the exchange rate for the dinar). This rate should include a moderate commission (up to 1%) to compensate the Government in part for the exchange risk it would bear.

3.30 A different solution would be preferable where the development banks borrow directly abroad instead of receiving loan funds on-lent by the Government. There would be merit, in such cases, in looking into an arrangement whereby the Government would give its exchange-risk guarantee and charge a commission which would vary according to the currencies involved in each loan. This would require that the Government set a reference interest rate for the counterpart in dinars of the external loans used by the development banks. The guarantee commission charged by the Government would be equal to the difference between this reference rate and the rate on the external loans. The development banks would then have no reason to prefer loans in strong currencies, with lower interest rates but a higher probability of future appreciation. In principle, the reference rates set by the authorities, which would serve as the basis for calculation of the guarantee commission, could vary according to credit selectivity criteria, depending on the end-use of the funds borrowed abroad. For example, lower reference rates could be set in the case of loans to be used in agriculture or tourism. However, it would be preferable not to mix the credit selectivity goals with the exchange risk guarantee mechanism. If it were considered necessary to subsidize certain loans, the subsidy should be borne by the Fonds de Bonification de Crédits et d'Investissements proposed in Chapter V and not disguised as special reductions in the exchange-risk guarantee commissions. The reference rate should therefore be uniform. It should be equal to the interest rate on domestic loans with the same term.

3.31 The following example illustrates how the proposed system would work:

	Loan Currencies		
	A	B	C
Development banks' lending rates on long-term loans	13.5%	13.5%	13.5%
Development banks' intermediation margins	2.5%	2.5%	2.5%
Reference rate	11.0%	11.0%	11.0%
Foreign-exchange loan rate	8.0%	10.0%	12.0%
Exchange-risk guarantee commission payable to the Government	3.0%	1.0%	-1.0%

In case C, the guarantee commission would in principle have to be negative, which means that the Government would have to add a premium of 1% to the exchange-risk guarantee. If the difference between the interest rates on domestic loans and foreign-currency loans exactly reflected the likelihood of exchange-rate appreciation or depreciation, the Government would recover the cost of this premium by realizing a gain on the exchange-risk guarantee transaction. Case C can arise in the normal way in foreign-currency loans which over time will tend to depreciate in relation to the dinar. But this case would occur also if the interest rate on domestic loans -- and therefore the reference rate -- were too low in relation to the international rates, having regard to future exchange-rate prospects. In the latter case the only way to avoid exchange-risk guarantee losses would be to raise the domestic interest rate levels.

3.32 If real interest rates were the same in Tunisia and on the international capital markets, and if the exchange rates of the various currencies tended to follow strictly the principle of parity of purchasing power, the commissions to be paid by the beneficiary banks would be sufficient to protect the Government against losses under the proposed exchange-rate guarantee system. In practice, these conditions rarely occur. If at any given moment the losses under the exchange-risk system looked like becoming too high, that would be a sign that domestic interest rates were too low in relation to international rates, taking into account the expected exchange-rate trend. This would mean increasing domestic interest rates. The recent losses suffered by the Treasury on foreign loan exchange-risk guarantees are largely explained by the fact that in real terms the interest rates on such loans after their conversion into dinars were considerably lower than world market rates. The recent increase in Tunisia's domestic interest rates and the charging of a 0.5% guarantee commission on bank overdrafts have been major steps toward correcting the existing imbalances. Nevertheless, it is not yet certain that these steps will be sufficient to reestablish equilibrium. In any case, the measures adopted are not sufficient to allow for the satisfactory operation of an exchange risk guarantee system for debts contracted abroad. To be complete, such a system demands differentiated guarantee commissions, depending on the interest rate and the prospective trends in each currency's rate of exchange, as proposed above in paras. 3.30 and 3.31.

C. Competition, Banking Specialization and the Creation of New Banks

Competition in the banking system

3.33 Even though Tunisia has ten deposit banks and nine development banks, competition within the banking system is limited. The weakness of competition is explained by a number of factors:

(a) The overall concentration of the deposit banks is fairly high. The two largest banks hold 50% of the total market of the deposit bank.

(b) Banking specialization reduces competition. The development banks do not enjoy the facility to compete with the commercial banks in receiving deposits, short-term credit (which accounts for about 60% of total lending) and current exchange operations. Moreover, certain development banks concentrate on specific operations or sectors (for example, BNDA and BNDT and the six banks with capital of other Arab countries do not engage in low-volume financing operations).

(c) The authorities set the lending and borrowing interest rates and commissions. They leave room for competition only in interest rates within very narrow limits and in long-term loans by the investment banks (in which interest rates are unregulated). There is, some degree of interest-rate competition between the banks within the authorized limits, but banking competition operates mainly through the quality of the service and marketing activities.

(d) The very detailed regulation by the authorities of the conditions on which the banks grant different kinds of loans, and the system of prior authorization by the Central Bank, restrict the ability of the banks to offer different terms.

(e) The ratio of 25% placement in public securities imposed on the deposit banks removes a substantial portion of their resources from the ambit of their credit policy and therefore from competition. Moreover, the special resources of deposit banks and development banks supplied by the Government or obtained abroad can be used only to finance selective operations. These are also cases in which it is not possible to maintain very active competition.

(f) The larger loan operations are almost always carried out by consortia with the simultaneous participation of several banking institutions. Their small size compels the deposit and development banks to participate regularly in consortium operations which represent a high percentage of their loan and participation portfolios. The consortium relationships that the banks have to maintain with each other are obviously not conducive to competition.

3.34 The development banks are at a competitive disadvantage in relation to the commercial banks in raising funds. The average cost of the resources of commercial banks in 1983 was only 6.5%, while during that same year it was practically impossible for the development banks to obtain third-party funds at rates below 10-12%. Thanks to their lower resource cost, the commercial banks realized a margin of about 3% on medium-term loans, on which they charged 9.5%. The average rate for new loan commitments of BDET was over 11.5%, and in spite of this the financial margin on its total portfolio did not rise above 1.5%.

3.35 The difference in cost of resources between the commercial banks and the development banks falsifies competition. It is to the advantage of a potential borrower to obtain the needed funds from the commercial banks at a lower rate even if the term is slightly shorter. The commercial banks are thus in a position of first refusal and can choose the best clients without doing a great deal of work. In contrast, the development banks, after having appraised a project, including the technical and financial improvements required to make it remunerative, sometimes see their clients turn to the commercial banks, which offer more advantageous terms.

3.36 Competition among the banks is advantageous so long as it leads to improvement of the financial instruments offered. The development banks have equipped themselves with the necessary professional staff and organizational structures to assist promoters to improve the design of their projects and to satisfy themselves that the projects are feasible and remunerative. Supervision of execution of the project is not only a control measure by the bank but also a service of technical assistance to the promoters. The commercial banks are not equipped to provide these services. By offering a financial instrument of lower quality at a price that does not allow the development banks to recoup their administrative costs and make a reasonable profit, the commercial banks in effect force the development banks to reduce the quality of their services to the detriment of sound project appraisal and supervision.

3.37 With the object of establishing more equitable conditions of competition between the deposit banks and the investment banks, consideration should be given to:

(i) maintaining the existing de facto deregulation of interest rates on long-term loans;

(ii) equalizing the cost of the resources used in medium-term loans, particularly to SMEs, granted by the deposit banks and the development banks.

3.38 The increase in interest rates on time deposits introduced in 1985 can slightly reduce the artificial advantage in cost of resources currently enjoyed by the deposit banks. This effect could be reinforced by the additional facilities for mobilization of resources by the development banks analyzed in paragraphs 3.17 through 3.32.

Independence of the development banks, and their relationships with the public sector

3.39 The new development banks have been set up as joint ventures with participations of 50% by the Tunisian Government and 50% by other Arab countries (Kuwait, Saudi Arabia, Qatar, the Emirates, Algeria and Libya). Consequently, the Tunisian representatives on the boards of directors of the banks are appointed by the Government, most of them being senior officials of the Central Bank, the Ministry of Finance, the Ministry of Planning and the Ministry of National Economy. Their role is to strike a balance between the interests of the bank of which they are directors and those of the Government. This role can sometimes be difficult because the two categories of interests do not always coincide.

3.40 The World Bank's experience, based on an analysis of 47 loans to development banks, indicates that the more autonomy a financial institution has in making its investment decisions the more capable it will be of maintaining sound operational policies and procedures. While it is recognized that the Government representatives in the new development banks have up to now discharged their duties in a responsible manner and have generally given precedence to the interests of the institution of which they are directors, it is recommended that the Government seek ways of safeguarding the independence of the development banks. For example, the Government could enlarge the boards of directors by adding members who are not government officials (university professors, businessmen, and independent experts). Another possibility would be for the Government, in consultation with the other shareholders, to sell part of its participations to individuals, companies or institutions, which could then appoint their representatives on the boards of directors of the new banks.

Bank intermediation margins

3.41 The intermediation margins of the Tunisian banks are lower than those found in many developing countries and lower even than those in a number of small and medium-sized developed countries (see Table 3.3).

3.42 The comparisons shown in Table 3.3 are far from strictly accurate because of the disparities between the various countries in the methods of classifying bank expenses, the criteria for determining depreciation and provisions, the calculation of profits, the size of the hidden reserves, the inclusion or exclusion in the balance sheets of security and acceptance commitments, etc. However, imprecise as the comparisons are, Table 3.3 shows that the advantage enjoyed by the Tunisian deposit banks in intermediation margins in relation to the banks of other countries lies essentially in personnel expenses. This advantage is probably explained by the combination of two factors: first, bank salaries are substantially lower than in the developed countries (which is only to be expected in view of the differences in per capita income); second, average productivity of bank personnel is undoubtedly higher than the average of other countries of comparable development level and, moreover, the productivity gap in relation to the developed countries is narrower than the salary gap.

3.43 The average size of the Tunisian deposit banks is smaller than the average in most of the countries mentioned in the comparison given in Table 3.3. Nevertheless, the comparison shows that bank intermediation costs in Tunisia are fairly low. This suggests that economies of scale do not have any substantial negative impact on the efficiency of the Tunisian banking system. To explore this point in greater depth, it will be helpful to analyze the correlation between the size of each of the ten Tunisian banks and their intermediation margins. The necessary statistical data are given in Table 3.4.

3.44 The fixing by the Central Bank of lending and borrowing interest rates to be applied by the banks has certainly been an important factor in their low intermediation margins. Because of the small differences between the average cost of resources and applications imposed by the Central Bank's interest-rate regulations, the Tunisian deposit banks have not been able to afford the high cost of inefficiency or the losses entailed in overly risky operations.

3.45 Table 3.4 shows that, generally speaking, the larger banks have lower operating costs. It therefore seems that economies of scale are a factor, though not a particularly important one, in the operating costs of the banks.

3.46 The reason that economies of scale do not appear to have a very marked impact is undoubtedly that, apart from the accounting differences in the presentation of the banks' balance sheets and operating accounts, their activities are not entirely homogeneous. Their operating costs are affected not only by differences in average scale of individual banks but also by differences in their resource and utilization structures and in the services they offer to their clients. Thus, for example, a very small bank like the BFT undoubtedly manages to have very favorable operating costs and very high profit margins because it seeks chiefly operations with very low unit administrative costs.

Table 3.3
Intermediation Margins of Deposit Banks
(as % of total assets) 1/

Country	Year	Operating Costs Total	Operating Costs Personnel	Deprn. and provisions	Total costs	Profit	Total intermediation margin
Tunisia	1981	2.1	1.4	1.1	3.2	0.6	3.8
Morocco	1981	3.0	2.2	0.9	3.9	1.1	5.0
Portugal	1977	2.7	2.0	1.5	4.2	0.3	4.5
Spain	1977	3.6	2.8	0.6	4.2	1.5	5.7
Belgium	1977	2.8	2.2	0.3	3.1	0.3	3.4
Denmark	1977	2.9	2.0	0.7	3.6	0.7	4.3
Finland	1977	3.2	1.6	0.7	3.9	0.4	4.4
Norway	1977	3.5	2.1	0.5	4.0	0.7	4.7

1/ Total assets is estimated on the basis of the geometrical mean of total assets at the start and end of each year. In the case of Tunisia the calculation does not include acceptance and security/surety debtors.

Source: Tunisia: Association Professionnelle des Banques.
Other countries: World Bank, Report on the Financial Sector of Morocco (1984)

Table 3.4
Intermediation Margins of Tunisian Banks, 1981
(as % of total assets) 1/

Bank	Total assets (millions of TD)	Operating Costs Total	Operating Costs Personnel	Deprn. and provisions	Net profit	Total intermediation margin
STB	578	1.5	1.0	0.8	0.8	3.1
BNT	430	1.8	1.4	1.4	0.6	3.8
BS	182	2.6	1.5	1.3	0.6	4.5
BIAT	177	2.6	1.5	0.8	0.6	4.0
UIB	173	2.5	1.8	1.1	0.6	4.2
UBCI	159	2.0	1.4	1.1	0.3	3.4
BT	148	2.5	1.4	1.9	0.5	4.9
CFTC	103	3.3	1.5	0.8	0.3	4.4
BFT	36	1.7	1.2	0.9	1.2	3.8
ABL	11	2.5	1.8	0.9	1.0	4.4
Average for deposit banks						
- weighted 2/		2.1	1.4	1.1	0.6	3.8
- unweighted	200	2.3	1.5	1.1	0.6	4.0
BDET	130	1.0	0.6	0.5	0.7	2.1

1/ See note to Table 3.3
2/ Weighted by total assets.

3.47 In spite of all the imprecisions, it seems that the creation of new banks would not do very much to improve the efficiency of the Tunisian banking system. The new banks would necessarily be small and would help to reduce the size of the existing banks. Their costs would tend to be above average, and it is almost certain that they would not do much to sharpen competition.

3.48 The last line of Table 3.4 gives data on the intermediation costs of the BDET. Because the other development banks were created only recently, their balance sheets and operating accounts are not yet sufficiently meaningful. The BDET's operating costs, particularly as regards personnel expenses and total intermediation margin, are quite favorable in comparison with those of the development banks of other countries. Operating costs are also lower than those of the deposit banks, which is to be expected, for two reasons: first, the development banks, which do not receive deposits, almost always have substantially lower administrative costs of resource mobilization than the commercial banks; second, their loan administration costs also tend to be lower, partly because their operations are generally higher in average amount than those of the deposit banks, and partly because their loans do not have such a high turnover as those of the commercial banks.

Bank specialization

3.49 Some of the existing banks already have fairly specialized activities: the BNDT concentrates on tourism and the BNDA on large agricultural and agroindustrial projects; the BDET is the only development bank to engage in financing of the SMEs, and the BNT is the only deposit bank operating on any substantial scale in agricultural credit.

3.50 Specialization, whether in a particular sector or branch of industry, in certain financial services (syndications, guarantees, search for financial partners) or in certain types of financing (export financing, leasing, participations), can offer substantial advantages. It makes it possible to build up a more thorough knowledge of the field of specialization and to use expertise and more efficient techniques to resolve the problems in that field, to reduce certain administrative expenses and to limit the requisite institutional infrastructures.

3.51 While specialization has its advantages, it also entails risks which increase with the degree of specialization. For this reason excessive specialization is inadvisable. Experience in Tunisia shows that the specialized institutions are excessively vulnerable to the difficulties of specific sectors and consequently often seek to diversify their activities (as in the cases of the BNT, which has converted from an agricultural bank to a commercial bank, and the BNDT, which is seeking to extend its activities to the construction sector). Diversification extending to several branches of economic activity and to projects that serve several different markets (local and international) will reduce the risks. It is also certain that in many projects the banks have to cooperate because the capital expenditures involved exceed the capacity of any single bank. On this point, attention is drawn to the necessity that all the banks involved in a given project perform their own appraisal to satisfy themselves that the project is financially and economically feasible and remunerative. Moreover, excessive specialization can reduce competition among the banks to the detriment of the investors.

3.52 It would therefore be inadvisable to impose more extensive banking specialization at the present time. The banks should have a certain freedom to choose their activities on the basis of their experience and of the actual demand for financial services. One of the advantages of having several banks with similar activities is that their clients are not limited to a single bank when they seek financing. In order to develop credit or resource mobilization procedures that require specialized appraisal, supervision or promotion techniques, it would be preferable to consider creating specialized departments in the existing institutions, or converting existing financial agencies, rather than creating new specialized banks.

Creation of new financial institutions

3.53 The number of financial institutions in Tunisia has risen sharply during the last ten years, with the establishment of new development banks. The major purpose in creating these new banks was to attract new foreign resources in the form of equity investment. The formula chosen, that of the development bank, was dictated by the desire to create institutions that would be geared to development of the productive sector in Tunisia and would strengthen economic relations between the shareholder countries.

3.54 The increase in the number of new development banks was justified mainly by the objective of bringing in capital from a number of Arab countries which agreed to participate in the establishment of separate institutions, one for each of those countries, but which it would be difficult to interest in joint participation in a single institution.

3.55 The number of financial institutions established on the Tunisian market is already rather high for its small size. Nevertheless, the creation of new financial institutions is a frequent topic of discussion. The text of the Sixth Economic and Social Development Plan refers to the possible establishment of a National Postal Bank, three Regional Investment Banks, one in each of the three priority regions under the Sixth Plan (North West, Center West and South West), and a National Foreign Trade Bank. There is much talk also of the establishment of an Emigrant Workers Bank, a Housing Bank, a Local Authorities Bank, and new deposit or development banks with foreign capital (mainly from Arab countries).

3.56 The proliferation of new financial institutions should be avoided, for a number of reasons:

(a) Even if economies of scale are not very large, they do play a significant role, particularly in the small banks; increasing the number of banking institutions would therefore raise the average cost of financial intermediation.

(b) In view of the arguments put forward in paragraphs 3.49 through 3.52, it would be inadvisable to create new, narrowly specialized institutions, except through conversion of existing non-banking financial agencies.

(c) To ensure the viability of the new institutions, particularly if they are specialized, it might be necessary to allocate special resources to them; however, special resource allocations can further fragment the financial system and create inequities in access to resources among the various institutions.

(d) As explained in paragraph 3.46, creating new banks would not necessarily stimulate competition in the financial sector.

3.57 In light of the guidelines set forth in paragraph 3.55, the creation of new institutions should be permitted only in the following cases:

(a) Conversion of existing institutions. The establishment of a National Postal Bank may be justified if, as provided in the Sixth Plan, it is based on the existing PTT network and replaces the National Savings Bank (Caisse d'Epargne Nationale) and the Postal Checking Center (Centre des Chèques Postaux). According to the Plan, this bank would be called upon to play the role of a small savers bank, to develop small savings and to replace the Commune Loans Fund (Caisse des Prêts aux Communes). Similar reasons would justify converting the CNEL into a Housing Bank.

(b) Establishment of institutions with specialized functions not yet represented on the Tunisian market -- essentially, leasing or lease credit (crédit-bail) companies. To ensure some measure of competition it would be reasonable to consider establishing three or four such companies. They should in principle be affiliated with existing deposit or investment banks to give them easy access to the requisite funds.

(c) Creation of institutions that bring in substantial amounts of foreign capital. As an exception to the general principle stated in paragraph 3.56, the creation of new deposit or investment banks could be acceptable if they helped bring in substantial amounts of resources from abroad (equity capital and loan funds), as in the case of the investment banks established recently with the participation of capital from other Arab countries. Even under these conditions it would be necessary (i) to encourage the promoters of new banks to consider acquiring or entering into association with an existing bank with the aim of strengthening and developing it, rather than setting up an additional bank; (ii) to avoid narrow specialization by the new banks; and (iii) to ensure that the volume of foreign equity funds contributed is indeed substantial.

3.58 As advocated in paragraph 3.56, the authorities should avoid setting up the other institutions referred to in paragraph 3.55:

(a) The establishment of a National Foreign Trade Bank might well introduce rigidity into the financing of foreign transactions. Restrictions should not be placed on the freedom to choose among several banks currently enjoyed by exporters, importers and other economic agents who need to conduct exchange operations or to obtain financing for their foreign transactions. The institution of an export credit insurance system is not a sufficient argument to justify setting up a Foreign Trade Bank as stated in the Sixth Plan. Moreover, the Plan provides that this system will be based on a non-banking mixed-capital company, which is the solution to be preferred. Also, the need to institute a system of medium- and long-term export financing hardly appears to justify establishing a Foreign Trade Bank. A medium- and long-term export financing system can function only with the support of the Central Bank (see Chapter VII). It would therefore be preferable to base the system on all the deposit and investment banks, which would operate under rules laid down by the Central Bank for granting its support.

(b) The establishment of regional banks should also be avoided. Having regard to their narrow resource market and the doubtful profitability of many of the investments they would be called upon to finance, such banks could survive only on the basis of special resources furnished by the Government. It would be less expensive and less risky to use the existing institutions, which could perform the same function more efficiently if they were given the special resources that the regional banks would need. The examples have to be borne in mind of regional financial institutions that have turned out not to be viable in the past and of the Southern Bank (Banque du Sud), which has had to extend its activities to other more developed regions in order to be able to grow.

(c) There seems to be little justification for establishing an Emigrant Workers Bank. There is already a bank with offices in France which in principle specializes in operations with workers. The other deposit banks could also be encouraged to involve themselves more in operations with emigrant workers and even to open offices in France. Finally, the proposed National Postal Bank should in principle accord high priority to operations with emigrants: transfers through the PTT network, savings transactions under functions inherited from the National Savings Bank (Caisse d'Epargne Nationale), and credit operations integrated into the proposed small savings functions.

(d) A Local Authorities Bank would not be needed if financing of local governments were effected by the National Postal Bank, referred to in para. 3.56 above, as is indeed provided for in the Sixth Plan, which states that the Commune Loan Fund (Caisse de Prêts aux Communes) would be merged into that bank.

The offshore banks

3.59 With the object of further developing and diversifying its financial system and promoting investment, Tunisia has since July 1976 allowed foreign banks to set up offshore banks and regional agency offices in Tunis. Some of the development banks also engage in offshore operations: they borrow abroad and lend in foreign currencies to nonresidents.

3.60 Law No. 76/63 of July 12, 1976 provides that the offshore banks can accept deposits of nonresidents, regardless of term and form, and all funds of foreign origin. They can also make loans of all kinds to nonresidents, including foreign enterprises prospecting for oil in Tunisia and export industries under the Law 72 system. They are exempt from the patente (business tax) for the first ten years of operation and are liable at the reduced rate of 20% for ten years thereafter. They are also exempt from the tax on income from securities in respect of their loan and deposit interest receipts. They are not subject to any constraints on repatriation of their income or proceeds abroad and can freely effect all transfers of funds belonging to them or to their nonresident clients. They cannot accept holdings belonging to residents on deposit or in any other form, grant loans to resident companies or participate in the capital of resident companies without the prior approval of the Central Bank of Tunisia.

3.61 Since 1976, nine offshore banks have been established in Tunis, but this number was reduced to seven in 1984 when two of the foreign banks left.

So far, the offshore banks have not participated in the capital of Tunisian export companies or granted credit to other residents because the interest rates charged on the international capital markets are notably higher than those of the Tunisian banks. Moreover, their regional activities have been limited by the relatively closed systems that are applied in Algeria and Libya.

3.62 In order to interest new foreign banks in opening offshore branches in Tunisia and gradually open up the Tunisian banking market to partial competition from abroad, the National Credit Board (Conseil National du Crédit) expressed the opinion in March 1985 that the possibility of offshore bank intervention in the financing of operations in Tunisia's domestic market should be envisaged. It was the Board's opinion that, following amendment of Law No. 76/63 of July 12, 1976, the offshore banks could be authorized to conduct certain operations with Tunisian residents, including:

- foreign-exchange financing, in the form of equity participations and medium- and long-term loans, of investment projects to be implemented in Tunisia;

- financing of stocks of certain imported intermediate goods, other than those benefiting from the general compensation decrease;

- financing of Tunisian exports;

- granting of purchaser's credits to foreign customers importing products manufactured in Tunisia;

- the conduct of related external trade operations, in particular domiciliation of import and export commercial paper, opening of letters of credit, prefinancing of export operations, and mobilization of claims abroad;

- the granting of bid bonds, guarantee bonds, and performance bonds to foreign companies awarded public or private contracts in Tunisia.

3.63 It is also realized that a number of additional advantages and relaxations should be introduced in the areas of taxation, customs tariffs and social security for the offshore establishments and their expatriate staff. The authorities have announced that they will be taking the necessary measures to ensure that the provision of possibilities for offshore bank intervention in new banking operations will take place within the framework of Central Bank discipline, taking account of the balance of payments situation and respecting the rules of balanced competition with the local banks (in particular as regards the tax regime and exchange control regulations).

3.64 With the new facilities, it is likely that the Tunisian authorities will succeed in increasing the interest of foreign banks in installing offshore agencies in Tunisia. This interest has become almost negligible in recent years. Two foreign banks have even abandoned their offshore operations in Tunisia. The new approach could have important positive effects on the balance of payments on the dynamization of Tunisia's banking system. In defining solutions offering sufficiently attractive advantages to the offshore banks and at the same time respecting the conditions of balanced competition with the local banks, the authorities are faced with the need to decide very carefully among a number of awkward and difficult choices, as they are indeed well aware.

Chapter IV

CREDIT POLICY

A. MONETARY POLICY AND OVERALL CREDIT POLICY

Growth of total domestic credit

4.01 The total volume of domestic credit distributed by the Tunisian financial system (monetary system and other financial institutions) has risen considerably faster during the last few years than domestic product. During the period 1975-84 real growth of credit volume averaged 9.5% a year, while GDP growth at constant prices was of the order of 5.5%. As a result, total outstanding domestic loans of the financial system, as a percentage of GDP, rose from 51% in 1975 to 69% in 1984 (see Table 4.1). This trend reflects the development of financial intermediation based on the progressive monetarization of the economy and the increases in financial savings and in external resources channeled through the financial institutions.

Table 4.1

Domestic Financing Provided by the Tunisian Financial System
(end-of-period figures)

	1975	1980	1981	1982	1983	1984
Millions of dinars						
Total	854	1,944	2,409	2,987	3,689	4,349
Monetary system	744	1,591	1,978	2,440	2,912	3,359
Other financial institutions	110	353	431	547	776	990 1/
Percent of GDP						
Total for monetary system and other financial institutions	51	55	58	62	68	69
Net crdt. balances on Govt.	6	8	8	8	9	9
Assistance to the economy	45	47	50	54	59	60

1/ Preliminary estimate.

Source: Central Bank of Tunisia, Financial Statistics.

Monetary system credit and recent monetary policy

4.02 The very rapid increase in total credit in nominal terms during the last few years is explained largely by the highly expansionist monetary policy applied since the beginning of the 1980s. During the period 1980-84, growth of the money supply (money plus quasi-money) averaged 18% a year, while real GDP growth averaged only 4.1% (Table 4.2). Moreover, since the income circulation velocity of M2 has fallen very little (from 2.6 in 1979 to 2.4 in 1984), the rapid monetary growth was accompanied by an average annual increase (of 10.8%) in the GDP deflator during the period 1980-84. 1/ The monetary expansion, in conjunction with substantial wage increases, has been an important factor in the rise in consumer prices and balance of payments pressures, which have been in part kept down by tightening of price control and of the import permits system. 2/ Measures of this type can temporarily reduce domestic and external disequilibria but are not a means for combating them efficiently and durably.

4.03 The rapidity of the monetary expansion was due mainly to the sharp increases in domestic credit of the monetary system (Central Bank and deposit banks) -- it grew by an average of 20.5% over 1980-84 (see Table 4.3 and Annex Table A.4.1). During this four-year period it was credit to the economy (private sector and public sector, excluding government) that enjoyed the largest increases: lending by the deposit banks to the economy expanded at an average annual rate of 20.0%.

Table 4.2

TUNISIA: Money Supply Indicators, GDP and Prices, 1979-83

	1979	1980	1981	1982	1983	1984
			(percentage changes)			
Money supply (M2) 3/	-	17.2	24.0	14.0	16.9	15.0
GDP at 1980 prices	-	4.3	5.7	0.3	4.8	5.5
GDP at current prices	-	19.4	17.8	16.2	14.6	13.0
GDP deflator	-	14.5	11.4	15.9	9.4	7.2
of which: excluding energy	-	(11.2)	(10.0)	(16.4)	(9.6)	(4.8)
Consumer prices	-	10.0	9.0	13.6	9.0	8.4
			(annual average)			
Income velocity of M2	2.64	2.69	2.59	2.61	2.5	2.4

Source: Central Bank of Tunisia, Financial Statistics.

1/ If we exclude the energy sector, heavily influenced by oil exports, the GDP deflator rose on average by 10.4% a year over the period 1980-84.
2/ The average annual increase in the consumer price index during the period 1980-83 was 10.0%.
3/ Based on average of quarterly figures.

Table 4.3

TUNISIA - Contributions to Growth of the Money Supply
1980-83

(% of growth of money supply)

	1980	1981	1982	1983	1984
External holdings (net)	11.6	16.1	5.0	36.1	-33.0
Domestic credit	105.6	138.2	141.9	124.3	157.3
Credit to the Government (net)	(2.2)	(12.8)	(15.8)	(12.5)	(34.0)
Credit to the economy	(103.4)	(125.4)	(126.1)	(111.8)	123.1
Special resources	-9.5	-11.7	-12.9	-8.3	-20.7
Other items (net)	-7.7	-42.6	-34.0	-52.1	- 3.2
Total	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Tunisia, Financial Statistics.

4.04 The expansion of credit in the monetary system was favored by the changes introduced into various monetary and credit policy instruments with the object essentially of enabling the deposit banks to respond more easily to the demands of the economy. As can be seen from Table 4.4, the major compulsory reserve ratio was reduced to zero; rediscounting facilities were sharply raised (in 1983 the overall ceiling on borrowing by the deposit banks from the Central Bank through rediscounting facilities, including the money market, was raised from 15% to 17.5% of their total demand, time and savings deposits; and, in spite of the high level of domestic inflation and the rise in world market interest rates, adjustments in the lending and borrowing rates applied by the Central Bank and the deposit banks have been slight. The Central Bank continues to apply a system of prior authorization to some categories of loans, on a case-by-case basis, in contrast to the general relaxation of monetary and credit policies. However, even in this field, conditions have been relaxed slightly and the use of this instrument does not appear to have contained the expansion of credit. The liberality of the Central Bank in granting funds (see Tables 4.5, A.4.2 and A.4.3) is adequately demonstrated by the fact that recourse by the deposit banks to the Central Bank during the period 1980-84 equaled over one-third of incremental assistance by the deposit banks to the economy.

Table 4.4

TUNISIA: Principal Monetary and Credit Policy Instruments
1979-84
(end of period)

	1979	1980	1981	1982	1983	1984
		(Percent)				
Compulsory reserve 1/	1.0	1.0 2/	3.0	—	— 3/	—
Interest rate						
Discount rate	5.75	5.75	7.00	7.00	7.00	7.00
12-18 month deposits	5.25	5.25	7.00	7.00	7.00	7.00
General discountable advances	7..-7.5	7.0-7.5	8.0-8.5	8.0-8.5	8.0-8.5	8.0-8.5
		(Millions of dinars)				
Rediscounting (total utilizations)	112.9	163.0	300.7	455.5	550.3	657.1
Regular quota	28.0	35.0	35.0	50.0	50.5	72.0
Utilizations	27.7	33.9	34.6	48.9	49.4	71.1
Grain quota	14.2	19.5	26.5	39.0	25.5	31.8
Utilizations	8.7	16.5	16.5	26.4	16.8	23.1
Olive oil quota	19.0	41.4	33.0	25.5	41.5	41.7
Utilizations	4.3	7.8	5.3	2.7	12.8	9.0
Medium-term rediscounting 4/	11.2	16.8	69.6	128.7	181.7	196.0
Paper accepted outside quota	55.4	80.7	157.3	228.6	257.5	325.1
Other (utilizations)	5.6	7.3	17.4	20.2	32.0	32.8
Money market (total loans-total borrowgs.)	27.5	32.6	28.2	23.5	36.1	77.6
Prior authorization						
Short-term credits						
Transaction paper in Tunisia	0.15	0.15	0.60	0.60	0.60	1.00
Agriculture, mining and manufacturing	0.15	0.15	0.60	0.60	0.60	1.00

Source: Central Bank of Tunisia, Financial Statistics.

1/ Applied to demand deposits and time deposits of one year or less.
2/ With effect from March 31, foreign accounts of nonresidents in foreign exchange have been deducted from the compulsory reserve base.
3/ Since August 10 foreign accounts in convertible dinars opened in the names of individuals of Tunisian nationality have not been taken into consideration in calculating the compulsory reserve base.
4/ Net of better-class housing loans and CNEL advance loans.

Table 4.5

TUNISIA: Deposit Banks: Credits to the Economy and Utilization of Central Bank Resources
1979-83

	1979	1980	1981	1982	1983	1984
	(Millions of dinars; end of period)					
Credits to the economy	950.4	1,156.3	1,454.6	1,764.8	2,148.4	2,396.4
Credit balances of Central Bank on deposit banks	157.1	195.6	325.5	484.8	580.1	688.3
of which: rediscounted paper	(111.4)	(158.5)	(296.2)	(446.9)	(541.8)	(648.7)
	(% changes)					
Credits to the economy	...	20.8	25.3	23.1	19.2	11.5
Credit balances of Central Bank on deposit banks	...	24.5	66.4	48.9	19.7	18.6
	(percent)					
Changes in credit balances of Central Bank/changes in credits to the economy	...	18.5	43.5	51.3	24.8	43.6

Source: Central Bank of Tunisia, Financial Statistics.

Credit by other financial establishments

4.05 In addition to bank credit, account has to be taken also of credit by the other financial institutions: CNEL, CENT and the development banks. Lending by these institutions has grown faster than lending by the deposit banks. Thus, the share of other financial institutions in total domestic financing rose from 13% in 1975 to 18% in 1980 and 21% in 1983.

4.06 The growth in the resources of the other financial institutions, which has fueled the accelerated expansion of their lending and participation activities, is explained basically by three factors (see Table 4.6):

(a) the more rapid expansion of savings deposits with CENT and CNEL than of total deposits with the commercial banks; while the latter have been more successful than CENT and CNEL in expanding savings deposits, their demand and time deposits have risen more slowly;

(b) the contribution of special resources: these resources, which include government and foreign loans, at present finance nearly half the assets of all the development banks together;

(c) the increase in equity funds: aggregate equity funds of "other financial institutions" rose from TD 33 million in 1980 to TD 210 million at the end of 1983 consequent upon the creation of new development banks with fairly high capital (see Chapter III). This expansion will probably continue, though at a slower rate, over the next few years, since the capital of a number of development banks has not yet been fully called.

Table 4.6

Resources of the Other Financial Institutions
(millions of dinars; end-of-period figures)

	1979	1980	1981	1982	1983
Total financing	308.8	353.2	431.1	547.0	776.3
Net credit balances on Govt.	54.0	62.4	80.5	96.5	116.2
Assistance to the economy	254.8	290.8	350.6	450.4	660.0
Resources	308.8	353.2	431.1	547.0	776.3
Money deposits	15.3	16.3	21.4	22.3	36.9
Quasi-money deposits	138.3	148.6	183.7	229.9	274.0
Special resources	111.3	130.2	164.7	205.7	289.9
of which: external loans	(101.7)	(111.6)	(130.1)	(159.8)	(212.3)
Own funds	31.3	32.7	84.7	153.7	210.5
Other items, net	12.6	25.4	-23.5	-64.6	-35.0

B. A NEW POLICY OF CONTROL OF GROWTH OF CREDIT

Imposition of credit ceilings

4.07 At present the authorities are not announcing explicit overall money and credit goals. To gain better control over inflation and the balance of payments deficit, the Tunisian authorities should adopt a system of predetermined goals for growth of the money supply. Such a system could in principle be based on one of the following procedures:

- control of total volume of domestic credit;
- control of the monetary base;
- control of interest rates.

4.08 The system applied at present is that of control of the monetary base. This system is based on control of the liquidity (central money) furnished by the Central Bank and held by the financial institutions and other economic agents. Control of the money supply through monetary base policy rests on two propositions: (i) the monetary base (i.e. the amount of central money, comprising fiduciary money and credit balances of the deposit banks, of other financial institutions and of enterprises and private individuals on the Central Bank) can be controlled by the monetary authorities (for example, through rediscounting policy and money market interventions), and (ii) the monetary base multiplier (ratio between the money supply and the monetary base) is stable, or at least its evolution can be foreseen and controlled without a wide margin of error. If the multiplier is stable, control of the monetary base automatically entails control of the total money supply.

4.09 It will be evident from the description given in paragraphs 4.02 through 4.04 that the application of a monetary base policy during the last few years has not produced very effective control of the total money supply. This situation is explained by two types of reasons:

(a) The authorities have decided to relax the limits on the expansion of the monetary base by raising from 15% to 17.5% of total deposits the ceiling on bank borrowing from the Central Bank through the rediscounting facility and the money market.

(b) The monetary base multiplier has fluctuated sharply. It is well known that the value of the multiplier increases with the reduction in the commercial bank's compulsory cash reserve ratio and with the reduction in the proportion of bank notes in the money supply. As can be seen in Table 4.7, since 1975 the multiplier has shown an overall upward trend owing to the general reduction in compulsory reserves (6.5% of deposits in 1975 to 0% in recent years) and the downward trend of the notes/deposits ratio (from 30.2% in 1975 to 20.1% in 1981, with a further increase up to 26.8% in 1984). In a number of striking cases the multiplier has evolved in the same direction as the compulsory reserve ratio by reason of the changes in the fiduciary money/deposits ratio. Thus, in 1979 the multiplier rose from 3.83 to 4.08 in spite of an increase in the compulsory reserve, because the fiduciary money/deposits ratio had fallen by about 13%. Moreover, in spite of the reduction in compulsory reserves in 1982 the multiplier declined slightly (from 4.03 to 3.91) because the fiduciary money/deposits ratio rose in that year by 36%.

4.10 In these circumstances it would be useful to study other alternative methods of controlling the money supply, in order to ascertain whether they offer means for enhancing monetary policy efficiency.

4.11 It would not be advisable to try to introduce a system of control of the money supply based essentially on the interest rate, mainly because it seems unlikely that the authorities would agree to raise interest rates sufficiently in the event it were necessary to prevent an excessive expansion of credit and of the money supply.

4.12 In contrast, a system meriting close consideration would be to place a ceiling on the total volume of credit to the economy. To implement such a system it would suffice to prescribe each year:

(a) an annual goal (WM) for growth of the money supply (in light of the forecasts of growth of real GDP, prices, and income velocity of the money supply);

Table 4.7

TUNISIA: MONEY SUPPLY, MONETARY BASE, COMPULSORY RESERVE AND MONEY MULTIPLIER, 1975-83
(millions of dinars; end of period)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Money supply (M2) 1/	667.8	772.3	875.9	1,049.7	1,219.2	1,445.1	1,724.8	2,050.5	2,430.6	271.53
Monetary base 1/ 2/	209.0	223.0	234.0	274.0	299.1	337.7	426.4	524.8	617.1	
Money multiplier (3) = (1)/(2)	3.20	3.46	3.74	3.83	4.08	4.28	4.05	3.91	3.94	
				(Percent)						
Compulsory reserve 2/	6.5	(Aug) 5.5	(April) 3.0 (July) 1.0	(July) 0	2.0 1.0	(Jan) 0 (July)	3/ 3.0 3.0	(May) 1.0 (Nov) —	(Mar) 0 (May)	4/ 0
Fiduciary money/deposits	32.2	31.5	25.5	25.8	22.5	21.0	20.1	27.3	28.1	26.8

Source: Central Bank of Tunisia, Financial Statistics.

1/ In accordance with the definition of IMF, International Financial Statistics.
2/ Applied to demand deposits and time deposits of one year or less.
3/ With effect from March 31 foreign accounts of non-residents in foreign exchange have been deducted from the compulsory reserve base.
4/ Since August 10 deposits in foreign accounts in convertible dinars opened in the names of individuals of Tunisian nationality have not been taken into consideration in calculating the compulsory reserve base.

(b) a goal (WNFA) for variation in net gold and foreign exchange holdings of the banking system (based on the forecasts and goals set for current and capital accounts);

(c) a forecast for banking system assistance to the Treasury (WNCPS). In view of the equality between the assets and liabilities of the banking system's consolidated balance sheet, to arrive at the ceiling to be set as the norm for expansion of credit to the economy (WCE) it would suffice 1/ to calculate the difference between WM and the sum WNFA + WNCPS.

4.13 The initial credit ceiling for each bank could be based on the level of credits to the economy granted by that bank at the time the system was introduced. Further increases in this ceiling could be based on increases in the volume of its resources (using different weightings for demand deposits, savings accounts or time deposits, emigrant workers' deposits and equity funds, as proposed in Chapter II). The ceilings set for each bank would be announced and reviewed every three months. Certain preferential loans, such as crop loans and short-term export credits, could be exempted from the ceiling.

4.14 In theory, the results produced by a credit ceiling system in terms of total money supply would be equivalent to those of a system of control of the monetary base with completely accurate forecasting of the trend of the multiplier. In practice, a system of capping of credit would probably permit stricter and more stringent control of the money supply. It would obviate the problems resulting from unforeseen changes in the monetary base multiplier. It would moreover compel the authorities to establish a clearer and closer link between their credit policy decisions and money supply growth goals reflecting the desired inflation and balance of payments trends. The credit ceiling system would in particular have the advantage of being better suited to the requirements of control of the balance of payments deficit. Setting limits for total expansion of credit would necessitate setting goals for net variations in foreign exchange reserves (net foreign exchange holdings of the banking system). It could thereby help to avoid excessive drawdown of these reserves by helping above all to contain import growth by gearing imports to foreign-exchange receipts from goods and services, transfers and net capital inflows. The system would thus slow down the rate of deterioration of the balance of payments and allow flexibility to be introduced into certain aspects of exchange control.

4.15 The introduction of a credit ceiling system would not necessarily increase the influence of government dirigisme on the Tunisian financial sector. The imposition of limits on credit expansion of each bank should be offset by abolition of the ceilings on refinancing of the banks through rediscounting and the money market. These ceilings would no longer be necessary, their purpose being exactly the same as that of the limits imposed under a credit capping system. The effects of such a system on the ability of the deposit banks to compete among themselves could be more or less the same as those of the existing system. Increases in the credit ceilings of each bank would be based on the increases in its deposits, whereas under the

1/ Assuming there are no changes in the "Other" item of the banking system's consolidated balance sheet.

present system the refinancing ceiling is based on the amount of its deposits. The introduction of the credit ceiling system would also have the advantage that it could make the authorities more willing to abolish the present system of prior authorization of loans; this system has the disadvantage that it causes the Central Bank to participate directly in decisions relating to specific loan operations, decisions that should be reserved exclusively to the deposit banks and the development banks. The authorities have already introduced measures for the gradual relaxation of the system (the threshold above which authorizations are required for most short-term lending, with the exception of export credits, was raised from TD 150,000 to 600,000 in 1981 and from TD 600,000 to 1 million in 1985). However, despite these measures, abolition of the prior-authorization system should be one of the priority measures to be taken for greater liberalization of the financial system.

4.16 Finally, a credit ceiling system would have the advantage of limiting the scope of the interest rate variations necessary for regulation of credit demand. Thus, credit capping often allows "interest rate economy" since credit demand is regulated not through upward adjustment of lending interest rates but through quantitative constraints on credit. For the same reason, capping is generally accompanied by an "interest rates viability economy": all other things being equal, interest rates are less volatile in a financial system in which credit capping is practiced durably than in a system in which a monetary base policy is applied.

Increasing of the compulsory reserve ratio

4.17 To improve the possibilities for control of the monetary base so as to make its growth compatible with credit limitation, it would be useful to raise the compulsory reserve ratio, currently zero, introducing differential rates according to the type of deposit (see Chapter II). A higher rate for demand deposits than for time deposits and savings accounts would be justified for the following reasons: (i) the interest rates on demand deposits are very low in comparison to those on time deposits and savings accounts; as a result, the incidence of the compulsory reserves in total marginal cost of the deposit banks is proportionately lower in the case of the reserves on demand deposits than in those on the other categories of deposits; (ii) the profit margins of the deposit banks in the utilization of demand deposit resources are very substantial, but this is not true of time deposit and savings account resources; (iii) the lower compulsory reserve ratios on time deposits and savings accounts will be justified if it is sought to sustain or enhance the interest of the commercial banks in these categories of deposits in spite of their higher interest rates; and (iv) if the savings deposits with CNEL and CENT remained exempt from the compulsory reserve requirements, it would be necessary to ensure that the reserve ratios on savings and time deposits with the commercial banks were not very high so as to avoid excessively distorting competition among the various categories of financial institutions.

4.18 As a counterpart to raising the compulsory reserve ratios for deposit banks, it will in principle be necessary to expand their refinancing facilities with the Central Bank. In addition, interest rate levels would have to be adjusted, at least in part, to variations in the cyclical economic situation and to the requirements of the credit limitation policy. These two points -- enhancement of Central Bank refinancing facilities, and increased interest rate flexibility -- are examined in the following sections.

Bank refinancing policy

4.19 Central Bank refinancing of the deposit banks takes place through two channels: rediscounting and the money market. The deposit banks are subject to a ceiling on total rediscounting for current transactions within the regular rediscounting and money market quota. This ceiling was raised on July 11, 1982 from 15% to 17.5% of aggregate demand deposits, time deposits and special savings accounts.

4.20 Rediscounting can take place within the regular quota, within special quotas, and outside the quota. Special quota and non-quota rediscounting applies only to certain types of selective credits (see Chapter V). The regular quota was raised to TD 50.5 million in 1983, and to TD 72 million in 1984. This quota is distributed among the banks pro rata to their deposits, short-term loans and equity funds. In addition, to encourage the banks to participate in the financing of small industry using the proceeds of the World Bank line of credit, each bank's regular quota is augmented by total outstanding loans disbursed by it from those proceeds. Central Bank assistance through the money market during the period May 1983 to February 1984 averaged TD 63 million (based on end-of-month figures).

4.21 The rediscount rate under the regular quota was recently increased from 7% to 9.25%. The one-day money market refinancing rate fluctuated during the period May 1984-December 1984 between 8.375% and 9%. The money market refinancing demands of each bank falling within the range 15-17.5% of its deposits can be met only through Central Bank intervention at the maximum bank overdraft rate, currently 10.5%. A penalty rate of 15% is applied when a bank's refinancing demands exceed the ceiling of 17.5% of its deposits.

4.22 The introduction of a system of credit limitation would make it possible to abolish direct control of total Central Bank refinancing based on the ceiling of 15% or 17.5% of deposits for total refinancing of each bank. Thus, by setting a ceiling on loans to the economy of a given commercial bank, the Central Bank would indirectly establish a limit on that bank's refinancing needs. Thus, for each unit of volume of credit granted by a bank there is a corresponding "central bank" money requirement, the level of which can be ascertained more or less accurately on the basis of the stability over time of the outflow factors (variations in net foreign holdings, compulsory and surplus reserve ratios, notes/deposits ratios; and since each credit ceiling would be based on the deposits of the bank concerned for a recent period, the correspondence between refinancing needs and volume of deposits would be maintained, although on an indirect and less rigid basis than at present.

4.23 Moreover, the increase in compulsory reserve ratios proposed in paragraph 4.13 would necessitate increasing the volume of Central Bank refinancing of the deposit banks so as to enable time to maintain the same level of total credit. This increase would be an additional argument in favor of abolishing the present rediscounting ceilings of 15% and 17.5% of deposits.

4.24 Introduction of the system of credit limitation and increasing of the compulsory reserve ratios would thus relegate refinancing, as an instrument of control of the money supply and of aggregate volume of credit, to a subsidiary role. Central Bank refinancing would nevertheless continue to play a fundamentally important role as an instrument of selective credit policy and a means for assuring the banks of all the liquidity they require to utilize their credit ceilings fully.

4.25 In the new system, refinancing could continue to be granted as at present through two channels: rediscounting and the money market. Rediscounting would be reserved exclusively for preferential loans, which in large measure corresponds to the present situation, in which nonpreferential loans can be rediscounted only within a relatively limited regular quota (only about 10% of total rediscounting). The additional liquidity needed by the development banks to finance nonpreferential loans within the credit limitation ceilings would have to come from the money market.

4.26 The rediscount rates would be fixed, while the money market rates would be variable, as at present. However, there would have to be greater uniformity that at present between rediscount rates, for the reasons stated in Chapter V and particularly because, in the event that certain interest rate subsidies were considered necessary, it would be preferable to grant explicit subsidies instead of using lower rediscount rates as the subsidy instrument (see Chapter V). To encourage the banks to interest themselves in preferential loans, the money market rates would need at all times to be higher than the rediscount rates and in principle would have to exceed the time deposit rates.

4.27 Each level of aggregate volume of credit set by capping would have to correspond to a certain level of the monetary base (in light of the values of the monetary base multiplier, the amount of the non-ceiling loans, the net foreign holdings of the deposit banks, etc.). This match would be necessary in order to avoid problems of bank liquidity surpluses or shortfalls in relation to their credit ceilings. In most cases the money market could assure this correspondence: if the banks lacked sufficient liquidity to utilize their credit ceilings fully, they would increase their demand for "central bank" money on the money market, and the monetary base would consequently increase to the level required to allow the credit ceiling to be reached. If, on the other hand, they had too much liquidity, the deposit banks should be able to sell it to the Central Bank at rates not below the marginal cost of their deposits, thereby helping to reduce the monetary base to levels compatible with the credit ceiling. This reasoning indicates that the authorities ought not to impose any limit on the interventions of a given bank on the money market. The necessary equilibrium between the volume of such interventions and the volume of deposits of each bank would be indirectly ensured by the credit ceilings, as explained in paragraph 4.18.

4.28 The balancing role of the money market should be utilized only to correct moderate or temporary discrepancies between the credit ceiling and the monetary base. However, the discrepancies could in certain circumstances become very large or permanent, e.g. as a consequence of sharp fluctuations in the monetary base multiplier, increased lending to the Treasury (if this is not subject to the credit ceiling), large shifts of deposits of commercial banks toward other financial institutions, or substantial variations in the net foreign holdings of the banking system. If these discrepancies began to reach high levels and to become persistent, the authorities should not rely exclusively on the money market to correct them. They could consider other measures:

(i) raising the compulsory reserve ratio in cases of surplus liquidity, and lowering it in the contrary case; variations in the monetary reserve ratio would have effects on the operating margins of the banks which would have to be taken into account in setting lending interest rates;

(ii) reducing rediscounting in cases of surplus liquidity by excluding certain loans from the rediscountable preferential loans category, reducing the proportion of each loan that can be rediscounted (e.g. from 80% to 60%) or setting rediscounting ceilings for each bank. The first two of these methods seem preferable to the third.

4.29 Control of the money supply based on control of the monetary base, as is the case at present, or on total control of domestic credit, as proposed in paragraphs 4.10-4.12, should in principle be accompanied by a system of unregulated interest rates. Changes in demand for credit in relation to supply would then trigger the interest rate adjustments needed to restore equilibrium. However, the present report does not in the short-term recommend abandoning the current system whereby interest rates are set by the authorities in favor of a system where interest rates would be freely determined by the market. The reasons for this are twofold:

(a) Perfect competition does not exist on the market. Experience in many other developing countries shows that, even when the number of banks operating in the market is greater than ten, perfect competition does not generally exist between them. The most frequently encountered situations are that interest rates are set under formal agreements, or "gentlemen's agreements" between the banks (representing one of the more visible forms of restrictions on competition), or alternatively that interest rates are announced by a leading bank and the others follow.

(b) Demand for credit is often very rigid in relation to interest rates, at least in the short-term. Sometimes a rise in interest rates will be accompanies by increased demand for credit (because enterprises facing liquidity problems need more credit to meet their interest payments). If the supply of credit is restricted by the authorities (to combat inflation or to help bring the balance of payments back into equilibrium), it will also be extremely rigid in relation to interest rates. In cases where credit supply and demand are extremely rigid, slight changes in supply or demand will give rise to large fluctuations in interest rates. Experience in several developing countries confirms this: in certain countries which deregulated interest rates but attempted to impose strict controls on money supply (Chile and Turkey are examples), interest rates rose excessively in real terms, seriously jeopardizing the financial equilibrium of industrial enterprises and the banking system. On the other hand, when credit supply and demand are rigid, interest rate controls permit greater stability and more acceptable interest rate levels, with modest rationing of credit volumes (a situation sometimes known as "interest rate economy"). If rationing becomes significant and thus starts to cause serious distortions, interest rates need to be raised to produce a more moderate degree of disequilibrium between credit supply and demand.

4.30 The considerations given in the preceding paragraph need to be read in conjunction with two basic remarks:

(a) Control of interest rates should not be allowed to lead to excessive disequilibrium between credit supply and demand, the discouragement of financial savings or the flight of capital abroad.

(b) The arguments presented are essentially valid in the short-term; in the medium- and longer-term, credit supply and demand equilibrium and improved efficiency in the allocation of financial resources will require greater interest rate flexibility, which can only be achieved through a gradual movement toward a system of interest rates more freely determined by the market.

In line with these two remarks, the present report accordingly recommends:

- raising the current level of interest rates (paragraphs 2.52-2.56 and 4.28-4.33);

- greater flexibility in average interest rate levels (paragraphs 4.34-4.36);

- wider permitted margins of fluctuation for certain lending interest rates (paragraphs 4.37 and 4.38);

- deregulation of certain interest rates (paragraphs 2.53 and 4.39).

C. LENDING INTEREST RATES POLICY

Raising of lending rates

4.31 The Tunisian economy is an "overdraft economy" in that the economic agents with financing deficits -- particularly the enterprises -- finance these deficits by calling on the financial intermediaries ("indirect financing" process), and the capital market and the direct financing processes associated with them play a residual role. In an overdraft economy the lending interest rates of the financial institutions play a central role since they affect the majority of financial operations.

4.32 Lending interest rates were increased in April 1985. Thus, for example, the rate on short-term paper for transactions on Tunisia, non-rediscountable, went up from 9.5% to 11%, the overdraft rate went up from 10.5% to 12.625%, and the ordinary medium-term lending rate went up from 10.5% to 12%. In 1984, the World Bank mission that prepared the present report recommended increases in lending rates averaging 1.2 to 1.5 points. The decisions taken by the Tunisian authorities in April 1985 represented a major step forward in implementing these recommendations, but a further increase in lending rates, averaging about 0.5 to 1 point, is necessary to match the additional increases in borrowing rates recommended in Chapter II (paras. 2.52 through 2.56).

4.33 To stimulate the development of medium- and long-term credit, advantage should be taken of the suggested rise to tighten up the lending rate structure. For example, the maximum rate authorized on the discount of commercial paper on Tunisia would rise from the present 9.5% to 11%, while the ordinary medium-term credit rate would rise from 10.5% to 11.5-11.75%.

4.34 The suggested rise in lending rates is comparatively slight. It would have an impact on the liquidity of the enterprises (through the increase in nominal rates) and on their profitability (essentially through the increase in real rates), but the scope of these effects would be limited. Since the wholesale price index rose during the period 1980-83 at an average annual rate of 10.7%, most of the enterprises paid interest on their debt at rates often lower than the rise in selling prices. Even in cases where real interest rates were positive, they have still been much lower than in most of the industrialized countries.

4.35 According to the most recent data furnished by the INS (Institut National de la Statistique -- National Statistics Institute) in connection with the Industrial Activities Census, in 1981 financial costs represented on average 3.7% of the aggregate value added of the industrial enterprises -- a very low figure in an international comparison. Thus, the proposed increase in lending rates would have an impact of less than 0.5% on total value added. It should also be noted that the interest paid by the enterprises is deductible from their taxable profits for purposes of the business and professional tax (patente). The true impact of an increase of 1% in interest rates on the after-tax profits of the profit-making enterprises is of the order of 0.6%. The impact of the suggested increase in lending rates is even smaller if we relate the enterprises' financial costs to their total costs. For 1981, again, financial costs represented about 2% of the total costs of the industrial enterprises. Combining this figure with the proposed rise in lending rates, and figuring in the tax deductibility, we see that the additional interest rate increases proposed would increase the enterprises' total cost by 0.2% at most. If this rise were reflected in full in selling prices, the inflation rate could also grow by 0.2%, all other things remaining equal. However, in the case of Tunisian firms subject to price control, profit margins would very probably absorb part of the burden of a limited adjustment required by the rise in lending rates.

4.36 To cushion the impact of the rise in lending rates on borrowers without jeopardizing government budgetary constraint, consideration could be given to a limited reduction in the TPS on interest paid to banks, from 8.69% (pre-tax rate) to 6%. This measure would for example increase the after-tax discount rate on short-term paper on Tunisia from 11.9% to 12.7% (rate calculated on pre-tax nominal rates) to 11% and 12%, respectively. The loss of tax revenue due to the proposed reduction in the TPS would be limited because the tax base would increase (owing to the increase in interest rates and the rising trend of lending volume). Although the TPS is a tax that is easy to collect, it has adverse effects on investment, financial intermediation and savings. It would therefore be preferable to try to develop other sources of fiscal revenue.

4.37 The proposed increase in nominal and real interest rates would alter the absolute remuneration of financial savings. In conjunction with changes in real wages it would also alter the relative price of production factors in Tunisia. To be able to determine the precise impact of a change in relative factor price on productive combinations and therefore on level of employment, we need to know the elasticity of substitution between factors. 1/ The World Bank report on employment characterized the relative cost of the production factors — capital and labor — as systematically skewed against labor by the incentives system and the economic environment. It is therefore to be expected that the suggested growth in the relative cost of capital, although modest, will help to limit the waste of capital and to stem the rise in unemployment.

Interest rate flexibility

4.38 The degree of flexibility of interest rates depends on the monetary policy applied. The policy of limitation of credit, recommended in paragraph 3.10 as a means of regulating growth of the money supply, makes it possible to diminish interest rate volatility in relation to the volatility that would be necessary if a monetary base policy were instituted, as explained in paragraph 3.12. In spite of this, interest rate levels cannot be totally independent of the requirements of the credit capping policy and of cyclical economic changes. It ought therefore to be possible to introduce interest rate changes with much greater flexibility than at present.

4.39 The deregulating of borrowing interest rates on time accounts at two years or more should be accompanied by greater flexibility in lending rates. Here again, implementation should be gradual, since it would be unrealistic and dangerous to change over rapidly to a system of largely deregulated interest rates.

4.40 In view of the need for a gradual approach to greater interest rate flexibility, consideration could be given to introducing a bank base rate system (currently applied partially) as the basis for setting all lending and borrowing interest rates. With this system, changing of the base rate would automatically trigger adjustment of the entire interest rate structure to changes in the inflation rate and other cyclical factors. The spreads between the bank base rate and the various interest rates would be more stable than the base rate itself but could be modified if the need arose. In principle, the base rate would be changed fairly frequently and the interest rate/base spreads less frequently.

4.41 In addition, the authorized margins for lending interest rates and certain bank commissions should be widened. The current authorized margins for lending rates are in general 0.5 interest rate points (the latter figure applies to certain loans rediscountable at the Central Bank). Tunisia's experience differs from that of most of the countries that apply this system of authorized ranges, in that the Tunisian banks, unlike their counterparts, have not systematically aligned themselves on the upper ends of the ranges. There is some competition between banks in terms of lending rates and commissions, and some Tunisian banks carry price competition to the point of assuming part of the tax liability of their customers or depositors on interest charged and received.

1/ According to work currently being done at the Faculty of Economics in Tunis, the value of this elasticity in Tunisia is apparently close to 1, illustrating the existence of a function of global production at substitutable factors.

4.42 To allow the commercial banks to tailor their lending rates to the customer risk (and not only to loan term or rediscountability), the spread of authorized lending rates should be widened, raising it by 1 to 1.5 points, depending on the type of loan. Similarly, bank commissions would be systematically set in the form of margins (in the case of commissions currently set in this way, the margins would be widened). Widening of the margins would thus serve to strengthen interest-rate competition between the banks and to adjust the actual lending rates to the customer risk.

4.43 A further recommendation relates to flexibility of interest rates on long-term loans. These rates should remain unregulated, as they are now. There should be provision for adjusting the rates from time to time, as is currently the case with the medium-term loans granted by the deposit banks. Adjustment of interest rates on long-term loans will be necessary in order to protect the development banks against the risk of excessive losses which could be caused by increases in the average cost of their resources.

Chapter V

SELECTIVE CREDIT POLICIES

A. Structure of Contributions from the Financial System to the Economy

5.01 The distribution of credit by type of operation and by sector of the economy is very much a matter of the selective policies instituted by the authorities. Some results of these policies are brought out by the statistical data given in Tables 5.1 and 5.2, which show: (a) the growth in outstanding medium- and long-term credit, which has considerably outstripped that in short-term credit; (b) the increasing role taken by the specialized lending institutions in total domestic financing; and (c) the marked rise in the percentage of financial resources absorbed by the industrial sector, mainly at the expense of the commercial sector.

Table 5.1

FINANCIAL SYSTEM CONTRIBUTIONS TO THE ECONOMY
(percentage of total: end-of-period figures)

	1975	1980	1981	1982	1983
Monetary system	87	82	82	82	82
short-term lending	55	49	48	48	46
medium-term lending	13	12	14	15	14
long-term lending	7	7	7	6	6
equity holdings and other contributions	12	14	14	14	13
Other financial institutions	13	18	18	18	21
Total	100	100	100	100	100

Source: Central Bank of Tunisia, Financial Statistics, May 1984.

Table 5.2

CREDIT RECORDED BY THE CENTRALE DE RISQUES,
BY BRANCH OF ECONOMIC ACTIVITY
(percentages of total: end-of-period figures)

	1975	1980	1981	1982	1983	1984
Agriculture	8.0	8.7	8.6	8.6	8.2	7.6
Industry	41.7	49.2	49.5	50.5	52.1	50.9
Mining	0.9	3.4	3.2	3.2	2.9	2.7
Energy	1.4	1.4	1.5	1.6	1.7	1.6
Manufacturing	33.6	38.9	39.4	40.0	41.1	40.6
Construction and public works	5.9	5.5	5.4	5.7	6.4	6.0
Services	50.3	42.1	41.8	40.8	39.5	41.4
Transportation	4.8	3.7	4.3	4.8	4.6	5.1
Tourism	12.0	7.3	6.3	6.0	6.5	7.1
Commerce	21.9	15.6	15.7	15.4	13.2	14.7
Other	11.6	15.5	15.5	14.6	15.2	14.5
Total	100.0	100.0	100.0	100.0	100.0	100.0

B. The Existing System of Selective Credit Policies

Diversity of selective credit policy objectives and instruments

5.02 The selective credit policies in force have a wide range of objectives. They are designed, inter alia, to increase the proportion of medium- and long-term credit in total financing, to encourage exports, and to foster the development of small- and medium-scale enterprises, the country's poorest regions, agriculture, tourism, the construction of low- and medium-income housing, and what the Plan designates as priority investments. These policies are often supplemented by others with an incentive or controlling purpose -- for instance, tax reductions and exemptions, or measures by specialized government agencies to promote investment or provide technical support. They are implemented through a multiplicity of instruments, examined in the following paragraphs: (i) rediscount policy; (ii) system of prior-authorization and rediscounting agreements; (iii) differentiation of interest rates; (iv) overall ratio of development financing; (v) specialized financial institution, and (vi) special-purpose government funds.

Rediscount policy

5.03 Most selective credit can be rediscounted, either under special quotas or outside the quota. The authorities have set special quotas for certain seasonal lending (grain, wine and olive oil quotas), for housing loans (quotas for special housing construction or purchase loans and a quota on advances against CNEL forward loans) and for the rediscounting of medium- and long-term credit. Discounts not subject to ceilings apply in particular to lending to government, export credit and inventory financing credit.

5.04 Nonquota rediscounts and those that come under special quotas benefit from preferential interest rates, which may be quite low compared with the regular rate of 9.25%: for example, 4% on credit for export prefinancing or the mobilization of claims abroad; 4.75% on seasonal crop loans; 5.5% on medium-term financing for agricultural investments; 6.5% on medium-term financing for investments in export industries; and 7.25% on government contract prefinancing credits.

5.05 At the end of 1984, total rediscounting under the special quotas (seasonal, medium-term and long-term) amounted to TD 262 million and total nonquota rediscounting to TD 325 million. Comparison of these figures with the regular quota limit of TD 72 million and preferential rediscount rate levels shows up the preponderance of selectivity objectives in Central Bank refinancing policy.

Prior authorization and rediscounting agreements

5.06 A high proportion of bank credits require prior authorization by the Central Bank and a rediscounting agreement. Prior authorization is required in the following cases: (a) for short-term credit to the agriculture, mining and manufacturing sectors and for paper transactions on Tunisia in excess of TD 1 million (TD 600,000 before 1985); (b) for short-term credit to other sectors or in other forms for amounts in excess of TD 100,000; (c) for most medium- and long-term credit. However, prior authorization is no longer required for (a) credit in the form of claims abroad and discounting of foreign paper, and (b) medium-term credit granted within the context of projects approved by API (Agence de Promotion des Investissements), by APIA (Agence de Promotion des Investissements Agricoles) or by the Sous-Commission des Agréments Touristiques where the establishment of a new business enterprise is involved.

5.07 A rediscounting agreement is required for (a) short-term credit in the form of commercial discount where the sum involved exceeds TD 1 million (TD 600,000 before February 1985); (b) all other forms of short-term credit which exceed a floor figure of TD 100,000 (TD 75,000 before February 1985); and (c) most medium- and long-term credit. However, credit not subject to prior authorization is also exempt from the rediscounting agreement requirement.

5.08 The system of prior authorization affects approximately 80% of all credit made available by the banking system. The principal aim of the system is not to control the volume of credit to the economy, which is held in check mainly by Central Bank refinancing limits and other measures affecting bank liquidity, but rather to influence the composition of credit. The Central Bank employs pre-authorizations and rediscounting agreements to impose very detailed conditions on the credit arrangements submitted to it, conditions having to do with their duration, the type of operation to be financed, the proportion of self-financing beneficiaries will be expected to put up, the borrower's financial position, etc.

Differentiation of interest rates

5.09 The interest rate scales set by the authorities are very detailed and show a very wide variety of rates. Short-term rates on loans from deposit banks range from 6% for export prefinancing credit and credit for the mobilization of claims abroad to 12.625% on overdrafts. There are for example rates of 6.75% for seasonal-crop prefinancing loans and 8% to 8.5% for crop-year loans and government contract prefinancing credits.

5.10 Where medium-term lending is concerned, banking and financial institutions charge rates as low as 4% (on loans approved within the context of government endeavors to encourage the development of tree-crop plantations) or 4.5% (on CNEL loans to holders of housing savings accounts) and as high as 12% to 14% (on development bank loans to large industrial complexes and for housing projects).

5.11 State agencies and social security funds often charge rates below the minima charged by the banking system. For instance: the rate of 3% on loans from the Fonds de Promotion du Logement pour les Salariés, on certain loans from the Fonds National d'Amélioration de l'Habitat and on reimbursable advances from FOPRODI; and the rate of 4% payable on housing loans from the Caisse de Sécurité Sociale.

5.12 The availability of subsidized rates on numerous types of credit operation rests on several formulas which allow government or Central Bank intervention: access to rediscounting at preferential rates; premiums and subsidies greeted by government funds; use of the resources of special funds and social security funds for the provision of loans at artificially low rates; and requirements that banks grant certain loans at rates below those they would set themselves if free to do so. One major formula is access to rediscounting at preferential rates. For instance, loans to finance the marketing of grains, olive oil and wine can be discounted with the Central Bank at 5.5%, within the framework of seasonal quotas, for up to 80% of the total amount, but deposit banks which make such funding available are required to charge an interest rate of only 6.75%.

Overall ratio of development financing

5.13 In order to ensure that banks participate more actively in medium- and long-term credit and channel a substantial proportion of their resources toward the financing of both public- and private-sector investment, the Central Bank requires certain usages of their funds within an overall ratio of development financing. The proportion of their funds they are expected to channel in this fashion is currently 43% of their demand, time and special savings account deposits (except foreign accounts in other currencies or convertible dinars opened in the names of Tunisian nationals). That proportion consists of a maximum of 25% in public paper (5% in CNEL bonds and the remainder in capital equipment bonds issued by the State) and a minimum of 18% in medium-term private credits, including BDET bonds. A "subratio," namely "the proportion of medium-term credit granted to small, artisanal and trade enterprises," has been introduced, representing a minimum of 2% within the ratio for medium-term private credits. With a view to building up the future role of the deposit banks (other than BNT) in the financing of agricultural investment, the monetary authorities have looked into the possibility of introducing a further sub-ratio for medium- and long-term credit to agriculture, likewise within the ratio for medium-term private-sector credits.

5.14 In cases of failure to meet the 18% requirement, the amount by which the institution is in deficit must be placed in a non-interest-bearing "provisional deposit" account with the Central Bank. In October 1984, the average value of the overall proportion of development financing was 36.7%, indicating a deficit of over six percentage points. A number of banks found it difficult to meet the minimum requirement for medium-term credit. The average ratio for these banks as a group was 16.2% October 1984 (against the required minimum of 18%). As regards the subratio for credit to small, artisanal and trade enterprises, the deposit banks achieved a proportion of no more than 1% on average, despite the required minimum of 2%. There were no problems with the obligatory placements in capital equipment bonds (for which a 20.4% ratio was recorded in October 1984). In contrast, subscription of CNEL bonds represented only 0.3%, despite the 5% minimum set. Apparently, the main reason for this deficit in the overall ratio of development finance has to do with the abundance of CNEL resources (see Chapter VIII), which explains this institution's lack of interest in attracting additional resources through the placement of bonds with the banking system.

Specialized financial institutions

5.15 The specialized institutions play a fundamental role in the selective distribution of credit resources. The group consists of: (a) BDET, which specializes in medium- and long-term financing, particularly for industry, including industrial SMEs; (b) the development banks which have attracted capital from the Middle East (STUSID, BTKD, BRQI, BTEI, BCMA), which concentrate their operations in medium-term equity holdings and credit for the financing of large-scale industrial, agroindustrial and tourism projects; (c) BNDT, which specializes in hotel credit and the financing of other tourism investments; (d) BNT, initially an agricultural bank, which, despite its gradual transformation into a commercial bank, still plays an essential role in financing agriculture, especially at short term; (e) BNDA, which mainly finances large-scale agricultural and agroindustrial projects; and (f) CNEL, which employs housing savings deposits to finance the construction and purchase of housing.

5.16 The way the financing made available by these specialized institutions is channeled into specific types of operation or toward specific sectors is determined by their statutes, by their customary line of business or by the nature of their resources. Several have access to special resources on favorable terms with an obligation to use them in specific areas of financing (see paragraphs 5.17 to 5.19 below). At the end of 1984, contributions to the economy by development banks and other specialized financial institutions represented approximately 20% of all domestic credit to the economy.

Special-purpose government funds

5.17 The authorities have established a number of official funds specifically to provide financial support for the development of certain priority production sectors: FOSDA (Fonds Spécial de Développement Agricole), FOSEP (Fonds Spécial de la Pêche), FOPRODI (Fonds de Promotion et de Décentralisation Industrielles), FOPROLOS (Fonds Social pour la Promotion du Logement des Salariés), FNAH (Fonds National d'Amélioration de l'Habitat), FOPRAM (Fonds National de Promotion de l'Artisanat et des Petits Métiers) and the Fonds de la Coopération et de la Mutualité. These Funds concentrate on credit to agriculture, fisheries, SMEs, investments in the less industrialized parts of the country, low-income housing, artisanal and small trade enterprises, reimbursable long-term advances at low interest (often around 4%), interest subsidies, financing for infrastructure projects, etc. They draw their resources mainly from the national budget but also from amortization payments and interest on loans granted in previous years. Access to their resources is provided through deposit banks and other financial institutions, which, in consideration of a commission, attend to disbursements and recoveries.

5.18 The Government, either directly or indirectly, makes other major contributions to the financing of the economy by transferring to the specialized institutions the proceeds of certain loans it raises abroad, either on the international capital market or from official agencies. These transfers are made under guarantees against exchange risk and they often have the benefit of subsidized interest rates obtained abroad (e.g. European Economic Community loans to BNDA) or they are accompanied with specific interest subsidies charged to the national budget (e.g. interest subsidies on loans negotiated by the Government on the international capital market and assigned to BNDT).

5.19 At the end of 1984, the special resources of the government funds or obtained by the Government abroad financed 12% of all banking system credit to the economy and over 40% of all contributions to the economy from other financial institutions.

5.20 Major funding of budget origin is also available to public enterprises (see Chapter IX). The State participates directly in the capital of these enterprises and in financing certain of their infrastructure investments. It also supports them with capital advances, mainly intended to finance specific infrastructure works, to make good certain operating deficits or to rationalize their operations.

5.21 Public-sector resources are also an important element in the financing of housing (see Chapter VIII). CNRPS (Caisse Nationale de Retraite et de Prévoyance Sociale) and CNSS (Caisse Nationale de Sécurité Sociale) provide a considerable proportion of the financing required for construction and purchase of housing. The social security organizations are expected to finance more than 10% of the investments (including site development) making up the housing program incorporated in the Sixth Economic and Social Development Plan. The national budget finances certain construction and housing loans and contains provision for major grants either to financial institutions or to households, particularly in connection with the rural housing program and the housing program for inhabitants of squatter settlements.

Negative aspects of the selective credit policy

5.22 Tunisia's selective lending system has proved effective in increasing the proportion of financial resources channeled into operations which, under normal circumstances, would not be of sufficient interest to deposit banks. Good examples of such operations are the granting of credit for agriculture, SMEs, housing, investment in the less developed parts of the country, etc. The system has also helped bring about a significant increase in medium- and long-term credit as a proportion of total credit. Nevertheless, as it now stands, it has a number of negative aspects:

(a) It is complex and confusing. This is a result of the very broad spectrum of interest rates, the diversity of sources of subsidies, the diversity of instruments employed, the multiplicity of institutions involved, the potential for duplication of benefits by virtue of the different credit instruments available and the different sources that can be tapped, the pervasiveness of bureaucratic formalities, the making of decisions on a case-by-case basis, etc. The plethora of sources of financing, eligibility criteria and loan terms and conditions leads to fragmentation of the financial system and less than optimal allocation of available resources.

(b) Selective credit is a heavy burden on the State, which cannot continue to bear the mounting burden it represents for the medium term. The total cost of the policy has not been computed, as it would be very difficult to establish, principally because the policy is implemented through a wide range of government funds and agencies, to which must be added the Central Bank. Nonetheless, the fragmentary data which are available on certain classes of subsidized credit demonstrate that the subsidy provisions and other selective features represent quite a substantial cost element in the budget. This cost comprises: interest rate subsidies on loans from the special funds and on other government lending; interest subsidies on loans granted by the banking system; subsidy spreads on Central Bank preferential rediscount rates (which constitute an additional drain on the budget to the extent they reduce Central Bank profits); assumption of the risk of default on loans guaranteed by the G vernment or its funds; exchange-risk guarantee on external borrowings; and the operating costs of the government departments which allocate credit or subsidies.

(c) The granting of loans on very favorable terms to offset the constraints (e.g. price control) imposed on activities in certain sectors is ineffective, from both the economic and social viewpoints: credit is granted to a minority of enterprises in each sector, whereas the prevailing constraints affect all enterprises.

(d) Selective credit makes for excessive disparities in the cost of different classes of credit. As noted earlier, there are types of medium- and long-term lending on which interest is payable at around 4% and others on which the rate goes as high as 14%. It would be difficult to justify this disparity on grounds of the differences between the social and private rates of return on investment projects and the operations of different production sectors.

(e) The low cost of subsidized credit produces an artificial increase in demand. In its turn, this leads to a rationing of credit and to administrative controls that seek to prevent interest rates which are highly subsidized and negative in real terms from causing the diversion of a proportion of preferential credit to other ends. In any event, such administrative controls are ineffective in many cases, their principal effect often being to hinder the access of small businessmen and small farmers to credit. Moreover, since total subsidies are as a rule proportional to total lending and a function of borrowers' creditworthiness, large-scale enterprises tend to be the chief beneficiaries of subsidy systems, while small and medium enterprises find themselves at a disadvantage.

(f) Selective lending is liable to create major distortions in methods of financing and in the allocation of financial resources. It discourages borrowers from using their own capital (since the subsidy component increases in step with the proportion of total financing accounted for by loan funds) and often forces the Central Bank to impose minimum requirements for capital contributions from borrowers. It encourages the wastage of capital, since the cost of this factor is artificially reduced, which leads to the creation of excess capacity and to projects far more likely to be capital intensive than labor intensive. Interest subsidies are linked to the cost of the capital investment financed rather than to the resulting value added. This probably opens the door to projects which have low value added in terms of international prices, which therefore make only a minor effective contribution to the Tunisian economy, and which prove profitable from the private viewpoint only by virtue of the heavy subsidies they receive.

C. Toward a New Selective Credit Policy

Measures to modify the present preferential credit policy

5.23 In order to offset the impact of the negative aspects of the present policy, as discussed above, it would be advantageous to study the potential for and advisability of instituting the following general measures:

- modification of the rediscounting policy;
- elimination of the prior authorization system;
- adjustment of the average level and range of preferential interest rates;
- change in the ratio of private medium-term credits;
- modification of the mechanism for subsidizing preferential credit.

These suggested measures are analyzed in the following paragraphs.

Modification of the rediscounting policy

5.24 As proposed in Chapter IV, only preferential credits should have the benefit of access to rediscounting by the Central Bank at fixed rates. Other credits should be refinanced only via the money market and at floating rates.

5.25 In principle, it would not be necessary to set rediscounting ceilings for selective credit arrangements. As explained in Chapter IV, the money supply can be controlled by curbing credit. Regulation of the monetary base, the growth of which would be kept in line with total credit expansion, would essentially be a matter of changing the volume of money-market operations. However, if growth of the monetary base proved persistently excessive in relation to credit ceilings, it would be necessary to limit the total rediscounted amount of selective credit (see paragraph 3.23). In such a case, it would be preferable to reduce the rediscountable percentage of certain types of credit (e.g. cutting the total eligible for rediscount from 80 to 60% of the value of a particular credit) instead of imposing ceilings on certain categories of credit. In fact, ceilings would lead to rationing mechanisms, which might create artificial differentiations between the benefits flowing to banks and to their customers. Care should be taken, however, not to reduce the benefits extended to export credits, for the reasons set forth in paragraphs 7.24 and 7.26. In order to avoid restricting the rediscounting of such credits, it may be necessary to use other methods to control the monetary base (e.g. raising the cash reserve requirement on demand deposits).

5.26 In keeping with what is proposed in the preceding paragraph, the ceilings on rediscount quotas should be done away with. Distinctions between quotas should be based only on the rediscounting rates applied and on the percentage of the amount of each credit which may be discounted. It would probably be enough to have two or three rediscount rates:

(a) One which covers export credits and possibly another for crop-year loans. The rediscount rates would be equal to the rates set for final users less a reasonable intermediation spread for the banks (e.g. 2.5%); in principle, they might be from two to five points below the rediscount rates on other types of credit, which is in fact the case at present.

(b) A rate for the rediscounting of medium-term credit; it should be a uniform rate and not heavily subsidized, because the subsidy would be granted to users directly (see paragraph 5.36 below). It should anyhow be slightly below the average commercial banks pay for their deposits (e.g. 0.5-1.0 point) as an incentive to attract them into the preferential credit field.

5.27 The development banks should also be able to rediscount some of their medium-term credit, although here ceilings would be justified, since these banks would not in principle be subject to control. As explained in Chapter III, allowing development banks to rediscount medium-term loans of the same type as are rediscounted by the deposit banks (loans to SMEs, in particular) would be essential if conditions for more equitable and healthier competition between the two types of financial institution, especially as regards the average cost of their resources were to be established.

Adjustment of the average level and range of preferential interest rates

5.28 In 1984, there was an excessively wide range of rates, showing marginal differences often difficult to justify. It was therefore important to simplify the interest rate system, and a number of measures were recommended by the World Bank mission that prepared the present report. The Tunisian authorities have already started to implement those recommendations, reducing (i) from 7 to 4 the number of lending rates on short-term credit; (ii) from 8 to 4 the number of lending rates on short-term rediscounting credit; (ii) from 4 to 3 the number of lending rates on medium-term credit; and (iv) from 5 to 3 the number of rediscounting rates on medium-term credit.

5.29 The difference between the most subsidized rate and the highest rate should not exceed 7 points. In 1984 there were differences of 11 points (taking account of the 3% and 4% interest rates on loans granted by certain special funds). A consequence of the proposed reduction in these differences would be that the lowest preferential rates would have to be around 7% or 8%. The necessary increases in these rates would be justified on the following grounds:

- It will be important to reduce the total drain on the national budget attributable to the policy of subsidized interest rates.

- Even after the increases proposed, certain subsidized interest rates would still be negative in real terms.

- Liquidity problems created by increasing nominal rates should be countered by introducing grace periods, progressive repayment plans and, if necessary, even the total or partial capitalization of interest over an initial period. Solutions of this type would be especially important in the case of housing credit and of loans for slow-maturing agricultural investments (e.g. establishment of tree plantations).

Changing the ratio of private medium-term credits

5.30 As long as there was only one development bank, the obligation on the deposit banks to make medium-term loans (up to seven years) was clearly justified, since it met the demand for funds for production investments. Since other development banks were created in 1981 and 1982, the question arises whether the ratio of medium-term private credits is still necessary.

5.31 It is preferable to encourage the deposit banks to contribute to this type of financing by using incentives rather than by requiring them to show a high ratio of medium-term credit. A first step in this direction could be to lower the medium-term private credit requirements from its present level of 18% to 15%. This recommendation -- made because of the need over the long term to ease the regulatory restrictions governing the banking system -- is based on the assumption that the banks would continue to be interested in granting medium-term credit to large enterprises, for the following reasons:

- Higher interest rates and the introduction of a certain degree of interest-rate flexibility would make medium-term lending more attractive to the banks.

- This credit would be rediscountable with the Central Bank at rates below the money market. The percentages of such credit eligible for Central Bank refinancing should be reduced, however, in order to preclude excessive expansion of the monetary base possibly resulting from the increase in the volume of medium-term credit for rediscounting.

- The banks would still be interested in meeting the demand for medium-term financing from their clients, especially large-scale enterprises, which bring them considerable benefits through other types of operation (current accounts, foreign trade and exchange operations, etc.).

5.32 If this assumption regarding the behavior of the banks were confirmed, the Tunisian authorities should at a later stage reduce the medium-term private credit ratio further still. If, on the contrary, the initial reduction proposed leads to a drop in the proportion of medium-term credit in deposit bank portfolios, the ratio should be moved back up.

5.33 It is also proposed that the required ratio of medium-term private paper should now incorporate a subratio, of 7%, for medium-term credit to SMEs and to small and medium farmers; that figure would include the present 2% subratio for credit to small, artisanal and trade enterprises (see Chapter VII). The purpose of this new subratio (in combination with the banks' subsidized intermediation spread on their credits to SMEs, as proposed in

Chapter VII) would be to foster greater interest on the part of the banks in lending to SMEs and small and medium farmers. This subratio should be introduced gradually.

Modification of the mechanism for subsidizing preferential credit

5.34 In order to ensure better coordination of the subsidies given on different categories of preferential credit and better control of the cost of such subsidies, it would be advisable to change the mechanism by which subsidies on preferential credit are distributed.

5.35 For short-term credit (crop-year loans and export credit), the most effective method of distributing subsidies is to use especially favorable rediscount rates, as is done at present.

5.36 The system of subsidizing interest rates on preferential credit channeled into investment projects should be different, however. Loan beneficiaries should receive the interest subsidy directly from their banks, independently of whether the credit is rediscounted or not with the Central Bank, as it would offset the dangers of excessive pressure from selective lending on expansion of the monetary base. This explains the proposal (paragraph 5.26) that the rediscount rate on medium-term preferential credit should be uniform and only lightly subsidized. A small subsidy would be enough to afford the banks a slightly more favorable intermediation spread on preferential credit and therefore to draw them into expanding their operations in this sphere.

5.37 All other concessions, including those now granted by FOPRODI, FODSA, etc., should be distributed by a single organization. To that end, the Treasury might set up a Credit and Investment Subsidy Fund (FBCI - Fonds de Bonification de Crédits et d'Investissement), to be financed by allocations from the national budget. The governmental departments and agencies specializing in sector policies (API, FOSDA, APIA, FOPRODI, etc.) would give their views on the projects to be subsidized or on the subsidy eligibility criteria to be applied, but the actual work of financial management would be concentrated in the hands of the proposed Fund. This solution would make it possible:

(a) to assess and control the cost of the policy of subsidizing interest rates and investment with greater precision;

(b) to orient the interest subsidization policy more on the basis of general criteria than on that of sectoral or fragmented criteria, which are often insufficiently coordinated, as at present.

5.38 The Treasury and the various government funds should not grant loans to enterprises, whether as repayable advances or under any other form. It would be preferable to channel all lending activity through the banking system. The Government could provide incentives or benefits for certain classes of banking system credit through the subsidization policy administered by FBCI, but it should not itself act in the place of the banks. This approach would reduce the fragmentation of the financial market, contribute to stricter discipline regarding the repayment of loans, and permit better monitoring and control of the cost of credit subsidy policies.

Chapter VI

FINANCING OF THE AGRICULTURE SECTOR

A. Investments in Agriculture and their Financing

6.01 Total investment in Tunisia's agriculture sector over the last 12 years is shown in Table 1. The country's investment effort in this sphere is in the middle range for medium-income countries (26% of GDP in 1979), as indicated below:

Table 6.1
AGRICULTURE SECTOR INVESTMENTS
(percentage)

	Tunisia		Morocco		Algeria	
	1960	1978-80	1960	1978-80	1960	1978-80
Investment Efforts						
Investments/GDP	17.0	29.0	10.0	23.0	42.0	44.0
Agr. Invest./Total Invest.	22.0	14.0	22.0	17.0	11.7	4.4
Agr. GDP/Total GDP	24.0	16.0	23.0	19.0	21.0	7.0

During the Fifth Plan (1977-1981), investment in agriculture was stepped up, the total rising from 17% to 24% of agricultural GDP and from 10% to 13% of total investment, although the share of agricultural investment (12.8%) in total investment was nevertheless below the sector contribution to national GDP (17%).

6.02 The public sector plays a major role in agricultural investment. Even so, its importance lessened in the course of the last decade: in 1969, public investment (TD 24.4 million) represented approximately 76% of all investment in the sector (TD 32 million); in 1980, 66%. The shares of the Government, the public enterprises and the private sector in that investment are shown in Table 2 below:

Table 6.2
AGRICULTURE SECTOR INVESTMENTS
(thousands of dinars)

	1977	1978	1979	1980	1981	Total V Plan		1982	1983	Total VI Plan 1/	
Administration	23,748	37,746	49,234	72,929	91,141	274,798	47	99,309	114,125	770,000	50
Public Enterprises	14,610	21,030	21,557	20,700	24,737	102,634	18	25,780	42,538	240,000	15
Private Sector	31,800	39,100	35,365	37,500	62,300	206,065	35	75,000	75,000	530,000	35
Total	70,158	97,876	106,156	131,129	178,178	587,497	100	200,089	231,663	1,550,000	100

1/ Projected in initial document.

The Government effort was focused principally on highly capital-intensive investments giving deferred results in irrigation (dams) and soil conservation. Private-sector investment was channeled mainly into stock-raising, tree crops and farm equipment. Its share of total agricultural investment rose steadily, from 24% in 1969 to 35% in 1981. Roughly 50% of the investment envisaged by the Sixth Plan is to be made by the Government, 15% by the public enterprises and 35% by private interests, proportions almost identical to those recorded during the Fifth Plan.

6.03 The Sixth Development Plan treats agriculture as one of the priority sectors. It seeks to raise all investment in the sector from 12.9% (Fifth Plan) to 18.9% of total investment, in other words from TD 913 million to TD 1,550 million (at average 1982-86 prices), an increase of 70% in real terms. An increase on such a scale cannot be achieved, however, without major, immediate steps to foster and channel public and private investment in the sector. Measures have already been taken or are now being studied which will encourage private investment in the sector; they include in particular the creation of (a) the Agence de Promotion des Investissements Agricoles (APIA) and (b) the Banque Nationale de Développement Agricole (BNDA). All the same, these new institutions will not become fully operational for some years, so that their role during the period of the Sixth Plan will necessarily be limited in effect. It will consequently be difficult to achieve the Plan goal of allocating 18.9% of investment to agriculture.

Financing of agricultural investment

6.04 Table 3 shows the sources of financing for private investment in agriculture during the Fifth and Sixth Plans:

Table 6.3

FINANCING OF PRIVATE INVESTMENT IN AGRICULTURE
(million TD)

	Plan V		Plan VI (plan figures)	
Total private investment	206.0	100	530.0	100
Financing				
Budget	0.3	1	-	-
Non-budget	6.1	3	8.0	2
FOSDA a/	78.9	38	170.0	32
Bank credits	70.6	34	246.0	46
Equity financing	50.1	24	106.0	20

a/ Special Fund for Agricultural Development (see para. 6.16).

According to Sixth Plan projections, the State will withdraw to some extent from the financing of private investment. Equity financing by farmers themselves, although doubled in absolute value, will constitute a slightly smaller proportion of the total than under the previous Plan. This disengagement on the part of the State and the relative decline in the share covered by equity financing will be offset by a very major increase in bank credit. This picture is predicated on the hypothesis that the new development banks and the deposit banks will agree to increase their commitments to this sector substantially.

6.05 The disengagement by the State will also affect the financing of agricultural investment by the public enterprises, as may be seen from the following table:

Table 6.4

FINANCING OF AGRICULTURAL INVESTMENT OF THE PUBLIC ENTERPRISES
(million TD)

	Plan V		Plan VI	
Total amount	105.2	100	240.0	100
Financing				
Budget	63.0	60	106.0	44
Non-budget	28.8	27	43.0	18
Equity financing	5.9	6	27.0	11
Bank credit	7.5	7	64.0	27

The funds from governmental sources during the course of the Sixth Plan will finance only 62% of the total cost of investment by the public enterprises, compared to 87% during the Fifth Plan. Financing with equity funds and, more important, the proceeds of bank credit will increase substantially, the latter covering 27% of total investment, compared to 7% during the Fifth Plan.

6.06 Of the total, the banking system (except FOSDA) will provide credit amounting to TD 310 million (TD 128 million of it at long term) for the financing of agricultural investment, a figure which constitutes nearly 20% of all investment by public and private enterprises in the course of the Sixth Plan, compared to TD 96 million and 16.5% during the Fifth Plan. The recent creation of the Agricultural Development Bank (BNDA) and of the new mixed-capital development banks, together with the stepping-up of commercial bank financing of agriculture, are the means on which the Government is counting to accomplish this objective.

B. Agricultural Credit Policy

Growth of credit to agriculture

6.07 Agriculture benefits from: direct credits to farmers for on-farm investments; loans to finance the harvesting, storage and marketing of farm products — made available through various agencies (chiefly the Office National de l'Huile and the Office des Céréales); and special loans and credit to finance the production and marketing of greenhouse products and the acquisition of farm equipment. The breakdown of outstanding credit made available to the agriculture sector over the period 1980-82 is shown in the following table:

Table 6.5

OUTSTANDING CREDIT TO AGRICULTURE
(millions of dinars; end-of-period figures)

	Short-Term Credit			Medium- and Long-Term Credit			Total Credit		
	1980	1981	1982	1980	1981	1982	1980	1981	1982
Direct credit	44	54	68	84	103	129	128	157	197
Indirect credit of which:	70	86	92	5	17	24	75	103	116
ONH	26	39	31	4	3	1	30	41	32
OC	26	28	36	-	-	-	26	28	36
Purchase of farm machinery	-	-	-	1	7	15	1	7	15
Greenhouse production	-	-	-	-	7	7	-	7	7
Total credit	114	140	160	89	120	153	203	260	313

At December 31, 1982 outstanding lending to agriculture amounted to TD 313 million, or 13.7% of total outstanding credit to the economy. From 1979 to 1982, credit to agriculture increased by 25.3% a year, a higher rate than was observed in other sectors. The proportion of medium- and long-term credit in total agricultural credit remained virtually constant at around 50%; this represented over 16% of total medium- and long-term loans to the economy, so that it corresponds to the sector contribution to national GDP.

Agricultural credit institutions

6.08 The institutional system by which agricultural credit is made available is a complex one, characterized by numerous sources of financing and a lack of uniformity in credit terms and conditions. The main institutions involved, to a greater or less degree, in the distribution of agricultural credit are:

(a) The Ministries of Agriculture, Planning and Finance, which formulate general agricultural policy and intervene directly in the distribution of credit from special resources, setting cost standards, loan and subsidy percentages, repayment periods and interest rates.

(b) The Agence de Promotion des Investissements Agricoles (APIA), responsible for promoting agricultural investment and administering the system of investment subsidies.

(c) The Central Bank of Tunisia (BCT), which provides major facilities for rediscounting credit to agriculture, at preferential rates.

(d) The National Bank of Tunisia (BNT), which plays a fundamental role in the agricultural credit system, whose functions are examined below, in paragraph 6.10.

(e) The other commercial banks, which have not so far evinced much interest in agricultural credit, mainly because they consider the intermediation margins insufficient and the risks of non-payment too high.

(f) The development banks (eight in number), including the new National Agriculture Development Bank (BNDA), which have so far entered the agricultural credit field to only a very limited extent but are now called upon to expand this part of their activity.

(g) The Sociétés de Caution Mutuelle Agricole (SCMAs) and the Caisses Locales de Crédit Mutuel (CLCMs), whose role is described in paragraph 6.11.

(h) The marketing agencies (Offices des céréales, de l'Huile, du Vin, etc.) which, in addition to their role in product marketing and storage, two fields they specialize in, grant -- from their own funds or from the proceeds of their bank borrowings -- seasonal farm loans affecting the products marketed through them (loans for purchases of seed, fertilizer, pesticides, etc.).

(i) The Offices de Mise en Valeur (OMVs), whose mission is to increase agricultural productivity in irrigated areas. Out of budget funds allocated to them for the purpose, they distribute seasonal farm loans in kind (seed, fertilizer, etc.), free of interest, to farmers located in their zones of action. Total annual lending by these Offices is relatively small, in the vicinity of TD 2 million. The cost of distributing this credit is very high: allowing for unrecoverable loans, it can in some cases reach over 40%.

(j) The numerous agricultural development projects cofinanced by external agencies, under which beneficiary farmers have access to supervised seasonal loans and investment loans, mostly administered by BNT.

(k) The Governorates which, under the Rural Development Program (PDR) financed from the national budget, grant medium- and long-term loans and subsidies for agricultural investment. This credit is distributed on the basis of criteria that are more often social than economic; the repayment rate is very low.

In addition, there is the specific but limited intervention of certain other agencies such as Société Tunisienne d'Electricité et de Gaz (STEG), which will provide farmers with electric well pumps on three-year terms. Suppliers of inputs (particularly farm machinery), are a not insignificant source of financing. The major part played by BNT, and the specific characteristics of the SCMAs and CLCMs, justify the outline description of their activities given in the following paragraphs.

6.09 National Bank of Tunisia (BNT): Set up initially by the State in 1959 under the aegis of the National Agricultural Bank as an institution specializing in agricultural credit operations, BNT was converted into a commercial bank in 1969 so that its agricultural loans could be subsidized from its operations in other sectors. The share of agricultural lending in total BNT credit to the economy has tended to decline slowly: in 1982, it was 41%, including advances to agricultural product marketing organizations, as against 45% in 1980. Nevertheless, BNT advances to the agriculture sector in 1982 accounted for 73% of the total banking-system credit to it.

6.10 BNT makes agricultural loans from its own resources (equity funds, deposits and rediscounting) and from the special resources placed at its disposal by the Government (budget funds, chiefly from FOSDA, and external loans). At the end of 1982, outstanding agricultural credit financed from BNT's own resources constituted 31% of all outstanding loans to the sector. The distribution by source of financing of the loans made in 1982 (Table 6) clearly reveals the predominance of BNT's own resources in the financing of short-term loans (83% of them) and of the special resources (FOSDA) it handled in the financing of medium- and long-term loans:

Table 6.6

SOURCES OF FINANCING IN BNT AGRICULTURAL LENDING (1982)
(million TD)

	BNT		FOSDA		WORLD BANK		USAID		OTHER		TOTAL	
	TD	%	TD	%	TD	%	TD	%	TD	%	TD	%
Short-term	20.1	84	-	-	pm	-	3.0	13	0.9	3	24.0	100
Medium-term	1.8	13	6.2	46	2.8	21	1.2	9	1.5	11	13.5	100
Long-term	-	-	4.5	60	0.7	1	-	-	2.3	39	7.5	100
Total	21.9	49	10.7	24	3.5	8	4.2	9	4.7	10	45.0	100

BNT's short-term credit to agriculture from its own funds takes two forms: loans granted directly to regular clients, who are generally farmers with relatively high incomes and good payment records; and loans granted through the SMCAs. BNT's special resources, which come mainly from FOSDA (budget funds), the World Bank and other external sources (EEC and USAID), are channeled mainly into medium- and long-term lending. BNT's role in the handling of FOSDA special loans is chiefly an administrative one. Decisions to grant loans are made by the Regional Agricultural Credit Committees, which are presided over by the Regional Agricultural Commissioners and on which the BNT representative holds a single, and therefore a minority, vote. BNT attends to the disbursement of loan proceeds, their recovery and the arrangement of the necessary guarantees; default risks, however, are assumed entirely by the State. Regarding loans financed from the World Bank line of credit, BNT alone is responsible for the decisions to grant them; it bears the entire risk of default on those to large farmers and 40% on loans to small and medium farmers. In consideration of its services in managing the loans made from its special resources, BNT, in most cases receives an annual commission of between 2% and 3% of total outstanding loan amounts.

6.11 The Sociétés de Caution Mutuelle (SCMAs) are empowered to guarantee loans made to their members, particularly by BNT. Their capital is variable and membership is obtained by subscribing a minimum share of TD 5. The members are small and medium farmers, but the definition of what constitutes a small or medium farm in fact excludes the majority of small farmers, 1/ who are not regarded as creditworthy. At the end of 1983, there were 243 SCMAs, with a total of 65,000 members. Because their own funds are so small, the SCMAs are not in a position to cover the risk to which they are exposed: 2/ at December 31, 1983, the capital of all these organizations as a group amounted to TD 410,000, while arrears on loans granted through them amounted to TD 14.4 million, or 65% of the total of overdue loans (TD 22.3 million).

6.12 Given this accumulation of arrears, the Government decided in September 1983 (a) to assume entire responsibility for SCMA arrears of more than one year (TD 10.7 million) and to reimburse that sum to BNT, which finances the loans involved, BNT being responsible for continuing the recovery efforts, and (b) to reorganize the SCMAs. The main measures instituted were:

(i) new loans for the 1983/84 crop season would be granted only to SCMA members who had repaid their 1982/83 loans;

(ii) ceilings on total guarantee of credit by an SCMA and of lending to any individual member were set of eight times the SCMA's capital and eight times the member's shareholding, respectively;

(iii) restructuring of the existing SCMAs and possible creation of new organizations on a geographical basis, that of the "imada" (village), and with a maximum of 200 members;

1/ Farms devoted to major crops are not entitled to SCMA financing unless they are larger than 10 ha, whereas over two-thirds of dry farming in Tunisia is conducted on smaller plots.

2/ That is, 25% of loans granted. The State carries 70 or 75%, depending on whether BNT approves the loans (and therefore bears 5% of the risk of default) or rejects them (and bears on no part of the risk).

(iv) appointment to each Regional Agricultural Credit Committee of a staff member of the Ministry of Agriculture, to be responsible for assisting the SMCAs in his area to organize and control their operations and management better.

These measures, in particular that described at (i), came into effect at the beginning of the 1983/84 crop year. Almost no loans have been granted this season through the SCMAs.

6.13 The Caisses Locales de Crédit Mutuel (CLCM): Created in 1963, these organizations provide their members with banking services (current accounts, time deposits) and short-term agricultural and non-agricultural credit. Initially, they were fairly successful, especially in regions where the cooperative movement had already developed. In 1969, there were 52 CLCMs, with some 70,000 members. Subsequently, however, poor management and the concentration of their activities in the agricultural sector made them vulnerable. Concurrently with the decision to promote the establishment of SCMAs, the authorities intervened by placing the CLCMs under the supervision of BNT and imposing severe constraints on their activity; the majority were finally wound up and transformed into branches of BNT. At the end of 1982, only 14 CLCMs remained, with a total of 30,000 members, and several of them still manage to show definite vitality. Consideration might therefore be given to encouraging and supporting this last group of CLCMs rather than doing away with them, which seems to be the authorities' intention.

Instruments of agricultural credit policy

6.14 The policy of supporting preferential credit for agriculture is implemented by means of a group of instruments which are discussed briefly in the following paragraphs.

6.15 Rediscounting facilities: The Central Bank has set special seasonal rediscounting quotas in favor of bank credit made available to finance the marketing of grain, olive oil and wine. This lending, which carries 6.75% interest, may be rediscounted with the Central Bank at 4.50% and up to 80% of their total. There are also special facilities for rediscounting (at 4.75%) credit granted through the SCMAs. Medium-term credit (less than 7 years) granted by the commercial banks from their own resources carries interest at 6.25% and can be rediscounted at 5.5%. In addition, deposit banks can rediscount (at 10.50%) up to 70% of long-term credit (less than 15 years) made available to finance investment in buildings for use in stockraising, establishment of tree-crop plantations, creation of water-supply points and irrigated areas, and acquisition of fishing equipment and tackle. This credit is made available, with Central Bank pre-authorization, at 12% 1/ and may amount to a maximum of 80% of the cost of a project.

6.16 FOSDA credit and subsidies: The Fonds Spécial de Développement Agricole, set up in 1963, is administered by BNT and from budget resources

1/ All interest and rediscounting rates mentioned in this paragraph are those that have been in force since March 1985. In 1984 these rates were lower (e.g. rediscounting rates of 4.25% for advances on grains, oils and wines; 4.00% for SCM-guaranteed short-term credit; 7.25% for long-term credit to finance agricultural investments, etc.).

finances medium- and long-term agricultural loans and subsidies to private investment in agriculture. FOSDA loans are made at interest rates with a strong grant element, of 3%, 4% and 6%, and are accompanied by subsidies averaging from 15% to 20% -- but in some cases as high as 60% — of total investment cost. A Ministerial Order fixes loan and subsidy amounts for each category. FOSDA resources come from annual budgetary allocations, which have grown steadily; in 1979, its loans and subsidies amounted to TD 17.5 million; in 1982, TD 26 million; and in 1983, TD 28 million.

6.17 Financing of agricultural credit from external resources raised by the Government: BNT, BNDA and other financial institutions obtain financial resources through external loans negotiated by the Government with the World Bank, the European Economic Community, USAID, etc. The Government assumes the exchange risk on such credit, grants interest subsidies and assumes part of the cost of managing the loan made, all of which means that very low interest rates can be set on agricultural loans made out of these resources. For instance, the Government assumes the credit risk on the third World Bank line of agricultural credit to BNT and remunerates BNT for its management of the loans granted from this funding by paying an annual commission of 3% on total outstandings. BNT lends to farmers as follows: (a) to small and medium farmers at 6%, and (b) to other farmers at 7%. In the World Bank loan to BNT, the Government bears the exchange risk and the difference between the interest received by BNT on the loans made and the interest of 8.25% paid to the World Bank.

6.18 Other Government incentives: Beginning in 1981, the Government introduced a series of measures designed to reinforce the policy of supporting financing for agriculture, in particular Law 82/67 of August 6, 1982. This legislation classifies investments and/or their promoters in three categories:

(a) Category A, investments made by small and medium farmers and fishing-vessel operators either in the form of specific projects or within the context of supervised regional programs.

(b) Category B, investments made by small and medium farmers and fishing-vessel operators in the form of small- or medium-scale integrated projects.

(c) Category C, investments made by large-scale operators in the form of specific or integrated projects or within the context of highly production-oriented ventures.

6.19 The benefits available in each of these categories are set out in annex Table A.6.1. Those common to all three consist in particular of tax relief and exemption of capital goods from import, manufacturing and sales duties and taxes. Specific financial benefits are also available in each category. Category A investments are henceforth to be the only ones with direct access to loans and subsidies charged to budget funds (FOSDA, FOSEP) without the requirement of prior APIA approval. Category B investments are financed with bank credit (and not with loans charged to budgetary resources); if approved by APIA, they benefit from interest-rate subsidies on the associated bank credit and from capital subsidies, being to allow farmers the same rates and subsidies as apply to FOSDA credit. Category C investments are financed with various types of bank credit, and when approved by APIA enjoy an interest-rate subsidy (out of FOSDA) of 3% or 3.5%, depending on the nature of the investment. Moreover, Category B and C preinvestment study costs are met by FOSDA up to a total of 1% of the amount of the investment and a ceiling. Finally, promoters of B and C have access to repayable advances not exceeding 80% and 50%, respectively, of the equity financing they are required to put up; 1/ this in fact constitutes a not insignificant capital subsidy (5-8% of total investment cost).

C. Problems of Agricultural Credit

6.20 In Tunisia, agricultural credit policy brings in its train the majority of adverse consequences already mentioned as being associated with the system of selective credit in general (paragraph 5.22): interest rates that are negative in real terms, artificial increase in the demand for credit; rationing of subsidized credit, complex administrative controls, risk of diversion of funds to other uses, fragmentation of the financial market, a heavy subsidy burden on the national budget, etc. Some problems specific to agricultural credit that call for priority attention are:

(a) the high cost of the subsidies granted;

(b) the inadequacy of the intermediation margins received by the banking institutions on agricultural loans;

(c) the enormous accumulation of arrears;

(d) the difficulty faced by small and medium farmers in gaining access to institutional credit.

These problems are discussed in the following paragraphs.

State subsidies

6.21 The Government's generous subsidy policy is a major and growing drain on the national budget. In 1982, over TD 9.5 million was distributed (FOSDA) in capital subsidies. Moreover, with an average of approximately TD 85 million outstanding in FOSDA loans, the grant element in interest rates for 1982 alone represented an additional TD 5.1 million approximately (at a nominal annual interest rate of 6% and a real resource opportunity cost estimated at 12%); FOSDA has also had to support BNT's operating costs (2% of outstandings at December 31, 1982) or roughly TD 1.7 million. Thus, FOSDA has by itself financed agricultural investment subsidies estimated at some TD 16.3 million (US$20 million). Moreover, the State bears the risk of default on loans made out of budget funds (FOSDA) or with its guarantee. At the end of 1982, FOSDA loans in arrears totaled about TD 20 million (22% of outstandings), of which over TD 2.2 million had been overdue more than five years and had to be regarded as non-recoverable. To these costs must be added (a) the subsidies granted through the rediscounting of agricultural loans at preferential rates by the Central Bank; (b) the assumption by the State of the default risk on loans carrying its guarantee (SCMA); (c) the cost of covering

1/ Grace period of 5 years, repayment over 12 years, interest rate 3-4%.

exchange risk on loans financed from external resources (including World Bank credit lines), and (d) the operating costs of the Offices de Mise en Valeur and arrears on their loans.

6.22 (a) State intervention: As a result of the reluctance of the banking system to involve itself in agricultural credit, the Government has become the major source of funds for such operations, utilizing BNT as administrator of the budgetary resources allocated to them. Since decisions to grant loans continue to be taken by government departments and agencies, and are often based on criteria other than economic or financial ones, the State has come to assume the risk associated with the loans it makes. The authorities (Ministry of Agriculture) are therefore playing the role of a financial institution, using the country's banks only for the accounting and payments services they afford. In promulgating the legislation of August 1982, the Government tried to exert stricter control over the granting of subsidies, in order to ensure that they were channeled first to small and medium farmers. These controls depend on complex administrative machinery, which increases the costs of credit distribution, although they are not particularly effective, since the definition of small and medium farmers (based on criteria of farm size) is very difficult to apply and enforce in practice. The official policy of heavily subsidized credit has therefore perpetuated intervention by the authorities in the distribution and management of agricultural credit and has precluded development of a self-sufficient rural financial system.

(b) Adminsitrative Intervention: A medium-term objective of the Government should be to reduce the use of budgetary resources for agricultural lending. Agricultural investments, particularly those of private farmers, should be financed through loans extended by financial institutions which should (i) be fully responsible for loan approval; and (ii) bear the entire associated credit risk. The role of government services, beside the definition of government's agricultural policy, should be to approve highly selective investment subsidies for priority investments and to supervise agricultural investments undertaken under development projects or benefiting from government subsidies.

6.23 Proliferation of credit programs: In the last ten years, more than 20 credit programs have been launched for farmers. Such proliferation fragments the agricultural credit market, causes less than optimum utilization of available resources, increases the number of middlemen, diminishes responsibility, and makes it difficult to monitor and manage the various sources of financing. Despite an effort of some years standing to coordinate the terms and conditions of credit offered and the procedures employed by the various existing sources of funds, differences still persist, particularly in the ways in which loan applications are appraised and recovery efforts managed. Farmers prefer to deal with those sources of financing that are quickest in processing applications, that offer the highest subsidies (PDR, FOSDA) and that are least zealous in pursuing loan recovery. Funds in this category are by their nature limited. Once they are exhausted, other investments for which they have been requested are often deferred until the next budget year. To resolve these problems, all agricultural loans should be made through uniform procedures and on standard terms, irrespective of the source of financing. Identical loans terms for all farmers would obviate the need to put applicants into different categories and therefore the need for administrative control (very difficult to apply, in any case) of the granting of the various types of subsidies. Identical conditions would also, incidentally, represent a credit subsidy to small farmers, credit with a relatively higher distribution cost.

Intermediation margins

6.24 The lack of initiative shown by the financial system in the financing of agriculture is due in large part to the inadequacy of authorized spreads on agricultural lending, which makes them insufficient to cover the management costs and high risks of such credit. The spreads approved by the Central Bank on credit which can be rediscounted at preferential rates are no more than 2.25%, 2.75% and 3% on short-, medium- and long-term arrangements respectively. The spreads on credit financed from special resources are only 2% or 3%. These margins do not reflect the high cost of managing these loans (low unit value) or the very high level of risk they involve. The spread BNT has to cover the cost of maintaining its agricultural portfolio was 1.1% of the asset-side total on its agricultural balance sheet, a clearly inadequate figure if the agency was to meet its operating expenses (2.3% of assets) and provide for bad debts (0.4%). As a result, BNT's agricultural lending in 1982 showed a loss of approximately TD 2.4 million (US$3.2 million). In order to maintain financial equilibrium, BNT should be able to command a minimum gross margin of 2.7% of its total agricultural portfolio. Its intermediation cost is similar to that of a commercial bank. It is low for agricultural operations (in Morocco, for instance, CNCA has a spread of approximately 4.5%) and reflects the limited human and material resources BNT devotes to its agricultural lending, particularly with respect to appraisal of applications and loan recovery. Furthermore, assuming that 10% of the total resources BNT devotes to agriculture should be equity capital, yielding around 10% after tax (20% before tax), the total intermediation spread (including profits) required would be 4.7% of BNT's total agricultural assets if its activities in this sphere are to prove financially viable (the same applies to Tunisia's other commercial banks).

6.25 At the end of 1982, BNT's doubtful reserve was equivalent to 1.8% of outstanding agricultural commitments, a very low figure when total arrears as of December 31 were TD 48.8 million (33% of commitments), of which TD 5.6 million had been in arrears since 1977 (i.e. over five years), alone constituting 3.8% of agricultural commitments and a sum necessarily considered not recoverable. At the moment, BNT has a full State guarantee for loans made out of budget funds and for SMA loans, as well as a partial guarantee for loans financed from external resources under development projects. The existing provisions can therefore be considered satisfactory. Nevertheless, if BNT were to assume the entire default risk on its agricultural loans, the provisions for doubtful and non-recoverable debts would have to rise to at least 4% of the total balance outstanding on agricultural loans. This would increase total intermediation costs, and consequently BNT's necessary gross spread, to approximately 5.0% of total agricultural portfolio. The average return on its agricultural commitments would then have to be about 11-12% per annum. 1/ The interest rates (non-subsidized) which BNT charges on its agricultural loans should therefore be set at an equivalent level. Unless spreads are increased to the extent just mentioned, the other commercial banks cannot be expected to show increased interest in agricultural lending.

Accumulation of unpaid debts

6.26 Overdue BNT loans (including direct, SCMA and FOSDA credits) show a very high average, which has tended to deteriorate in recent years (from 27% of receivables in 1980 to 28.7% in 1983).

6.27 Recovery rates on BNT agricultural loans vary according to the category of resources from which they are financed. There is undoubtedly a correlation between recovery levels and the share of default risk assumed by BNT.

Table 6.7

RECOVERY RATES, BY SOURCE OF FUNDS (12/31/83)

	Risk assumed by BNT (%)	Recovery rate %
Ordinary resources	100	88
SCMAs	0-5	35
World Bank	25-100	63
FOSDA/FOSEP	0	48
Integrated projects	0-40	15-41

Although BNT is responsible for recoveries on all loans it handles (even those for which it assumes no risk), its efforts seem more effective in cases where it assumes all or part of the risk. It is essential that agricultural loan recoveries be improved so that it will be possible to:

(a) reduce the cost of credit distribution and the necessary intermediation spreads;

(b) utilize the resources committed (budget allocations or bank equity funds) more effectively by allowing better recycling of loans;

(c) encourage the financial institutions to increase their commitments in the agricultural sector;

(d) reach more farmers by diminishing the risk element devolving upon the banks; and

(e) mitigate the induced adverse effects of the present tendency of some loan beneficiaries to regard their contractual obligations to lenders too lightly.

6.28 In recent years, BNT has attempted to improve the recovery rates on its farm loans; however, the measures instituted, although necessary, do not appear to have been telling enough, as may be seen from the recent decline in those rates. In practice, BNT possesses no truly effective means of effecting

1/ Assuming the average cost of the resources committed by BNT to be 5% per annum.

recoveries, despite the sureties it requires for a loan. Action in the courts, slow and costly, cannot be taken against a multitude of borrowers. Moreover, attachment and execution proceedings are difficult to pursue in the present social and economic environment in Tunisia. New structures and better-designed programs within BNT itself would not be enough to bring about a substantial improvement unless such efforts were backed up by concrete measures on the part of the Government to restore the necessary degree of financial discipline among borrowers. The Government has recently taken steps to improve farm loan recoveries and provide the financial institutions with a partial guarantee of their commitments in the sector; it decided to reorganize the SCMAs and grant General Privilege of the Treasury in connection with the recovery of loans financed from budget resources (FOSDA) or with benefit of State guarantee (SCMAs, integrated projects). Privilege of the Treasury makes it possible to circumvent the judicial process and effect rapid recovery of overdue loans through the Ministry of Finance. The Government also recently defined operating conditions and procedures for the Fonds National de Garantie (FNG), actually created in 1981 but operational only as of January 1984. It will now provide security for bank participation in the financing of SMEs, principally agricultural, by: (a) refinancing arrears; and (b) taking over nonrecoverable loans. Nevertheless, a bank which grants a loan must bear 30% of the risk of default. With recovery levels as they now are, it would appear difficult: (a) for a commercial bank to accept that degree of risk unless it can be offset through the spread available; (b) for the Government to cope with the financial obligations FNG will bring.

6.29 An improvement in recovery rates is therefore an essential prerequisite for the restructuring and further development of the agricultural credit system in Tunisia. The seriousness of the present situation requires that the Government take rapid and energetic initiatives to remedy it. It must, however, be taken into account that a large portion of the arrears is due to the difficulties caused by the drought in recent years. In cases where it is clear that the drought is a dominant factor in the formation of existing arrears, plans should be made for their rescheduling. If rescheduling should result in the arrears being converted into medium-term lending operations, there would be many more possibilities for repayment. By obviating the need for judicial procedures such as attachment and forced sale, rescheduling would help not only the debtors but also the lending institutions avoid difficulties and losses. However, it would be necessary to take the necessary precautions to strictly limit rescheduling operations to those cases in which the arrears are essentially due to drought-related problems.

Access to and rationing of agricultural credit

6.30 Short-term credit: No study has been made on the extent -- in terms of volume and number of farmers affected -- of informal (i.e. non-institutional) credit made available by landowners, authorized sales agents or other businessmen, or parents and friends. Consequently, no reliable statistical data are available. However, given the relative difficulty of access to short-term institutional credit, informal sources would appear to play a not insignificant role in the financing of seasonal farm credit.

6.31 Institutional seasonal farm credit is made available in cash or in kind. Bank credit comes largely from BNT and the SCMAs. A negligible number of large farmers also obtain seasonal credit from the commercial banks. In 1982, the number of farmers who actually made use of bank seasonal credit was estimated at a maximum of 30,000, or less than 10% of Tunisia's 330,000 farmers. Some farmers, although without access to bank credit, do obtain credit in kind from governmental marketing organizations (the Offices de l'Huile, des Céréales) or development agencies (Offices de Mise en Valeur). An estimated maximum of 20,000 farmers appear to have annual access to the various sources of credit in kind.

6.32 The number of farmers with access to one form or other of seasonal credit is therefore probably in the vicinity of 60,000, or less than 20% of the total of private farmers in Tunisia. Although the available figures are incomplete or unreliable, it is fairly safe to say that, although all classes of farmers may have access to credit in kind (particularly within the context of development projects), it is generally those who work medium- and large-sized land areas who have access to seasonal credit either in kind or in cash: (a) the commercial banks, including BNT, give credit only to their good clients; (b) only those farmers who work more than what is regarded as a feasible surface area can become members of the SCMAs and have the benefit of their loans; (c) the majority of credits in kind are distributed by the OCs and the other grain cooperatives to the minority of farmers engaged in commercial-scale farming; (d) the farmers, even on a small scale, who obtain credits from the Offices de Mise en Valeur as part of public irrigation projects are in a privileged position compared to farmers who work small rainfed farms.

6.33 Export credit: Although it is impossible to give the exact figure, the maximum number of farmers who benefit annually from medium- or long-term credit from one or other of the available sources of financing can be estimated at a maximum of 20,000 (less than 10% of Tunisian farmers), while the total number benefiting from one (or several) medium- and long-term loans at the end of 1983 was approximately 80,000 (less than 25%).

6.34 To ensure that the investment credit needs of small and medium farmers are more fully met, part of the proceeds of external loans (such as the World Bank lines of credit to BNT) are reserved for lending to them. Moreover, the implementation of regional development projects increases the resources available to finance this group, thanks to the farm credit components they include (APMANE, Programme d'Assistance au PMA dans le Nord-Est, Projet de Développement des Petites et Moyennes Exploitations du Kef et de Siliana; International Fund for Agricultural Development; rural roads; etc.). In addition, recent regulatory legislation (August 1982) directs that the major part of the overall FOSDA budget be channeled to small and medium farmers. Finally, in order to facilitate access to seasonal farm loans for this group, steps have been introduced to rationalize and revitalize the SCMAs, while the law of March 2, 1981 simplifies the procedure for obtaining Certificates of Possession, which, in cases where farms that are to benefit from credit do not appear on local property registers, serve as collateral for long-term investment loans.

6.35 Despite the measures enumerated above, the present situation of rationing is not conducive to the use of investment credit by small and medium farmers. The high subsidy element in most investment credit programs leads to a level of demand which exceeds available resources by a long way. The definition of small and medium farmers 1/ contained in the Law of August 1982 covers over 90% of Tunisian farmers. Furthermore, verification of the declarations of farm size made by loan applicants -- and therefore, by extension, application of the law itself -- proves difficult in most cases. Consequently, it would seem that the great majority of small farmers, less well-informed as to the institutional sources of financing available to them, less influential in financial and administrative circles, and regarded as less creditworthy by the lending institutions, are the main victims of this situation of credit rationing.

1/ Farms of less than 60 ha under major crops; 5 ha under market-garden crops; 30 ha under rainfed tree crops; 1 ha of greenhouse crops; (Decree no. 83/25 of January 14, 1983).

Chapter VII

FINANCING OF INDUSTRY

Investments in the manufacturing sector

7.01 Investments in manufacturing increased over the period 1980-1983 at an average of 34% a year. Table 7.1 shows that after quite moderate growth in 1982, the performance of the industrial sector improved notably in 1983.

Table 7.1

SOME INDUSTRIAL SECTOR INDICATORS

(in millions of dinars)

	1980	1981	1982	1983	1984	Avge. growth (%)
GDP - 1980 prices	3,510.0	3,736.0	3,736.0	3,915.0	4,130.0	4.2%
GDP Mfg. Industry - 1980 prices	416.0	469.0	482.0	522.0	571.0	8.2%
GDP Mfg. Ind. as % of GDP	11.8	12.4	12.9	13.3	13.8	
Investment - current prices	982.0	1,290.0	1,565.0	1,630.0	1,900.0	17.9%
Inv. Mfg. Industry - current prices	131.0	228.0	284.0	360.0	360.0	28.3%
Inv. Mfg. Ind. as % of Inv.	13.3	17.6	18.1	22.1	19.0	

7.02 Investment by branch of activity and by sector (i.e. public or private) is shown in Table A.7.1 in the Annex. Table 7.2 below shows the share of each branch and each sector for the period 1980-1983:

Table 7.2

INVESTMENT BY BRANCH AND BY SECTOR
(1980-1983)

	Public		Public		Total	
	Amount	%	Amount	%	Amount	%
Agriculture and food	96.8	57.3	72.2	42.7	169.0	18.5
Building materials	173.0	69.7	75.1	30.3	248.1	27.2
Mech. and elect. industs.	58.3	38.0	95.2	62.0	153.5	16.3
Chemical industries	145.7	88.4	19.2	11.6	164.9	18.1
Textile industries	18.6	18.8	80.5	81.2	99.1	10.9
Other	14.2	18.4	63.1	81.6	77.3	8.5
Total	506.6	55.5	405.3	44.5	911.9	100.0

Investment is quite evenly spread among the various branches of industry, the building materials branch leading with 27.2% of all investment over the period. Investment in the chemical and in the mechanical and electrical industries, however, grew at the highest rates.

7.03 Investment by the public sector in industry remained predominant at an average of 55% of all such investment between 1980 and 1983, but the Government intends to cut back the State role in the sector (see Chapter IX). This predominance of public investment has had a major influence on the structure of the industrial apparatus and its financing. As Table 7.2 shows, investment by the public sector was particularly heavy in chemicals (fertilizers), building materials (cement) and agricultural products and foodstuffs (sugar).

7.04 API statistics on arrangements to invest in new enterprises in 1983 demonstrate that projects requiring investment of less than TD 1 million generated 76.5% the new jobs at a per-job investment cost equivalent to only 21% of that incurred by enterprises investing over TD 1 million (see Table 7.3 below and Table A.7.2 of the Annex). The majority of projects requiring investment of more than TD 1 million are implemented by enterprises in which the State participates directly or indirectly.

Table 7.3

ARRANGEMENTS TO INVEST IN MANUFACTURING, ACCORDING TO API

	TD 75,000-TD 1 million	Over TD 1 million
Number of projects	626	71
Investment (millions of TD)	157	406
Jobs	13,976	7,656
Average cost per job	11,235	53,030
Average cost per project	250,800	5,720,000
Average of jobs per project	22	108

7.05 API statistics also show that investment arrangements in 1982 (TD 694 million) and 1983 (TD 695 million) increased significantly by comparison with the previous years (TD 450 million in 1980 and 1981 - see Table A.7.3 in the Annex). Since some years elapse between initial investment arrangements and execution of a project, investments in manufacturing are likely to exceed the investment level envisaged by the Sixth Plan. Investment carried out in 1982/83 (TD 571 million) represented 35.7% of the total (TD 1.6 billion) expected for 1982-1986, the period covered by the Plan.

Financing of manufacturing enterprises

7.6 Since no consolidated balance sheet is available for manufacturing enterprises, rigorous quantitative analysis of the financial structure of these enterprises is impossible. Important data are, however, to be found in Table 7.4, which summarizes the manufacturing industries financing program for the period covered by the Sixth Economic and Social Development Plan.

Table 7.4

MANUFACTURING INDUSTRIES FINANCING PROGRAM FOR THE SIXTH PLAN PERIOD

	Public Enterprises	Private Enterprises	Total
	(millions of dinars)		
Financing needs			
Investments	780	820	1600
Repayments	260	171	431
Other Uses	70	109	179
Total	1110	1100	2210
Financing resources			
Equity financing	372	190	562
State contributions	85	129	214
Equity holdings	(75)	-	(75)
FOPRODI advances	-	(49)	(49)
Decentralization subsidies	(10)	(70)	(80)
FOPRAM	-	(10)	(10)
Bank contributions	68	46	114
External contributions	25	125	150
Medium- and long-term credit			
Domestic	192	351	543
Of which FOPRODI credit	-	(33)	(33)
External	331	122	453

Source: Sixth Economic and Social Development Plan (1982-86), Part IV, Chapter 2.

7.07 Table 7.4 highlights the importance of State contributions in the financing of both public and private enterprises. The Sixth Plan relies on almost 15% of the financing needs of private manufacturing enterprises being covered by FOPRODI advances and credit, by decentralization subsidies and by FOPRAM (Fond de l'Artisanat et Petits Métiers).

7.08 The Plan also relies on the banking system to cover 23% of the financing needs of public enterprises and 36% of those of private enterprises, without counting the short-term and external credit guaranteed by the Tunisian banks.

7.09 Manufacturing has absorbed a growing share of banking-system credit (deposit and investment banks). According to the Centrale des Risques, this share increased from 33.6% in 1975 to 38.9% in 1980 and to 40.7% in 1983.

Table 7.5

CREDIT TO MANUFACTURING INDUSTRIES RECORDED BY THE CENTRALE DES RISQUES

	1975	1980	1981	1982	1983	1984 (August)
			(millions of dinars)			
Short-term credit	150	358	432	554	670	783
Medium- and long-term credit	69	215	293	363	447	493
Total	219	573	725	917	1,117	1,276
		(Percentage of credit to all sectors)				
Short-term credit	34.9	39.7	40.1	41.0	42.6	41.6
Medium- and long-term credit	31.0	37.8	38.5	38.6	38.9	39.2
Total	33.6	38.9	39.4	40.0	41.0	40.6

Source: Central Bank of Tunisia, Financial Statistics.

7.10 No detailed statistical data are available to allow a comparison of changing deposit-bank and investment-bank financing patterns. It is clear, nevertheless, that over the last few years, which have seen the establishment of a number of well-capitalized investment banks, the role of these institutions in the financing of manufacturing enterprises has expanded considerably. This trend is apparent from Table 7.6.

Table 7.6

BANK CONTRIBUTION TO INVESTMENTS BY MANUFACTURING ENTERPRISES

	1981	1982	1983	1984 (estimate)
Deposit banks	91	140	139	127
Investment banks	24	76	154	230
Total	115	216	293	357

Source: Ministry of Planning

7.11 The development banks are expected to take over the role of the State in the financing of numerous public enterprises (see Chapter IX). Throughout the Sixth Plan, they will also continue to play a major role in financing investment by private manufacturing enterprises, whether in the form of equity participations or medium- and long-term credit, or by servicing as intermediaries in the mobilization of external loans (see Chapter III).

State intervention in credit to industry

7.12 In addition to its overall objective of fostering industrial development in general, the State's policy of intervention in credit to industry seeks in particular to encourage small and medium enterprises, the establishment of new enterprises in the country's less developed regions, and export industries. The benefits provided through the policy of selective credit to industry consist essentially of the rediscounting policy, the ratio of medium-term private credits, interest rate differentiation and the action of such government funds as FOPRODI, FOPRAM and FNG. All these measures have been examined in detail in Chapter IV, but a number of specific observations are added here on the role of the special funds mentioned.

7.13 FOPRODI (Fonds de Promotion et de Décentralisation Industrielle), set up pursuant to Law 73-82 of December 31, 1973, is designed to assist businessmen, encourage the creation and development of small and medium enterprises, and institute incentives for the decentralization of industrial investment. FOPRODI assistance takes in the following forms:

(a) Repayable advances made to promoters of projects to enable them to retain 51% of the capital in the enterprise to be set up. These advances are available only for projects requiring total investment not exceeding TD 500,000, working capital included, and they are given for 12 years, including 5 grace years, at 3% interest.

(b) Medium- and long-term credit for new projects requiring total investment not exceeding TD 75,000 and expansion projects where, again, the investment requirement is under TD 75,000, working capital excluded. This credit, which may not exceed 70% of the total investment, is made available at 4% interest for a maximum of 10 years (including 5 grace years) for new projects and a maximum of 7 years (with no grace period) for expansions.

(c) Coverage of the first half-year's interest on medium- and long-term loans from the banking system for new projects requiring investment over TD 75,000 but under TD 250,000, working capital included.

(d) coverage of expenses incurred in implementing such investment incentive measures in the country's less developed regions as investment and interest subsidies and assumption of necessary project infrastructure works.

7.14 FOPRODI expenditure up to December 31, 1983 is shown in Table 7.7:

Table 7.7

FINANCIAL BENEFITS GIVEN THROUGH FOPRODI, UP TO DECEMBER 31, 1983

	Number of beneficiaries	Millions of dinars
Repayable advances to enterprises	696	17,253
Credit to SMEs	441	11,918
Coverage of first half-year's interest	86	3,208
Subsidies to foster industrial decentralization:		
Interest subsidies	224	1,116
Investment subsidies	252	1,739
Infrastructure costs	33	253

7.15 The benefits available through FOPRODI give rise to the following observations:

(a) Interest on repayable advances should be raised to between 8% and 10% at least. The present 3% rate is markedly negative in real terms. If inflation remained at the levels of the last few years, the real value of repayments would fall rapidly, the 3% rate converting a major proportion of repayable advances into outright grants. In place of a subsidy tied to a FOPRODI equity advance, it would be preferable to provide investment subsidies determined by specific project characteristics (e.g. employment created, contribution to exports, value added at international prices). If promoters who obtain repayable advances from FOPRODI are successful, they could easily reimburse them at interest rates with less of a subsidy element than at present. If an enterprise has temporary difficulties of liquidity or profitability during start-up, it would be preferable to capitalize interest over a four- or five-year grace period instead of subsidizing it too heavily. Enterprises which are not successful would certainly have difficulty paying higher interest rates, but if their problems cannot be solved by capitalizing interest during a grace period it will be because -- in the majority of cases -- they are not viable businesses and therefore merit no subsidies at all.

(b) The 4% interest rate on FOPRODI investment loans to SMEs is too heavily subsidized and should be increased at least to 10% (except for export-oriented projects) for the reasons already set out in Chapter V and for other reasons similar to those given regarding FOPRODI repayable advances. Besides, the quite small number of enterprises which have so far had the benefit of FOPRODI loans suggests that there are considerable inequalities in the access of SMEs to this facility.

(c) Coverage of interest during the first six months of the life of medium- and long-term loans arranged with the banking system should be eliminated for reasons similar to those set out above.

(d) The interest rate subsidies available on bank loans to finance investments in the less developed regions of the country (zones in Groups B and C, as per the classification indicated in Decree 77-578 of July 6, 1977, amended by Decree 79-251 of March 21, 1979) are quite high: they can be as much as five percentage points, while the rate the beneficiary enterprise pays may be less than 5%. In keeping with the recommendations made in Chapter V, these subsidies should be reduced, and the minimum rate paid by the beneficiary increased to at least 8%.

7.16 FOPRAM (Fonds National de Promotion de l'Artisanat et des Petits Métiers), set up under the terms of Law 81-76 of August 9, 1981, is designed to promote projects (not on a commercial scale) in the artisinal and small trades sector undertaken by Tunisian nationals, particularly emigrant workers who can show proof of the appropriate qualifications and undertake to devote themselves full-time to their projects. FOPRAM aid is available in the following forms:

(a) Repayable advances to make up the equity capital needed to carry out approved projects. The promoter is expected to put up at least 10% of the equity capital when the total cost is under TD 10,000 and 20% when it is between TD 10,000 and TD 20,000. In both cases, equity capital is expected to cover at least 40% of total project cost. The advances bear no interest and are repayable over a minimum period of 11 years, including 1 grace year.

(b) Coverage of interest during start-up on investment loans obtained from banks, the limit on this type of arrangement being 12 months from the date of the first disbursement of loan proceeds.

(c) Guarantee of bank investment loans, through FNG. They may cover up to 60% of investment cost.

7.17 FOPRAM contributions to equity capital provide one type of support for new businessmen in the artisanal and small trades sector, and a most important one, since these businessmen are generally unable to come up with the necessary equity capital themselves. The guaranteeing of bank loans to small, artisanal and trade enterprises is also very important, given the difficulties the majority of beneficiaries would have in obtaining bank credit with the inadequate collateral they can offer.

7.18 Nevertheless, it would be preferable to charge interest on FOPRAM advances for equity capital. The rate should perhaps be 8%, which would still provide a hefty subsidy. Thought should also be given to eliminating coverage of interest during start-up periods on loans from banks, on grounds similar to those given above regarding the very heavily subsidized interest rate on FOPRODI's repayable advances, namely: (a) with inflation, the real value of repayments on FOPRAM advances would fall rapidly, so that in real terms a considerable proportion of each advance would in fact be converted into a grant; (b) it would be difficult to justify high subsidies for successful enterprises able to repay their advances without difficulty after an appropriate grace period when interest could be capitalized; (c) enterprises unable to meet moderate interest payments after an appropriate grace period cannot, in principle, be considered viable, exposing the State to loss not only of interest revenue but also of the nominal value of the FOPRAM advance, and frequently even a part of the investment credit guaranteed by FNG. The development of small, artisanal and trade enterprises would very probably be better served if the government resources now absorbed in FOPRAM interest subsidies were diverted into financing technical assistance for them.

7.19 FNG (Fonds National de Garantie), established by Law 81-100 of December 31, 1981, provides guarantees mainly for small and medium agricultural, industrial and artisanal production units, primarily in connection with credits obtained to finance projects for the establishment or expansion of such units and their export operations. An FNG guarantee covers between 50% and 75% of outstanding principal. The banks assume the risk in respect of the balance of the principal and the interest.

7.20 The main problems associated with FNG activity are: (a) the guarantee commission rate payable by the beneficiary; (b) the percentage coverage provided by its guarantee; and (c) the sizes of enterprise entitled to its guarantee.

7.21 FNG derives its funds from the following sources: (a) a 5/8% levy on short-term bank overdrafts not representing rediscountable credits; (b) a one-time levy of 1/8% on investment loans not eligible for FNG guarantee granted by banks out of their equity resources to nonagricultural sectors; and a 1/8% one-time levy on the total amount of guaranteed credit, paid by the beneficiaries of such guarantees. FNG began its activities too recently to allow a reasoned opinion to be formed on what would constitute an appropriate commission rate to be paid by beneficiaries throughout the duration of their credit. Although there is justification for including a subsidy element in it, the rate should not be too low if heavy losses are not to burden the budget and the charges on nonguaranteed credits are not to rise excessively. Higher guarantee commissions could also encourage entrepreneurs to become more aware of their responsibilities to avoid waste and ensure that their business ventures are managed properly. The 1/8% one-time levy charged on guaranteed credit should be converted into an annual commission at a higher rate.

7.22 In the case of irrecoverable short- and medium-term farming and fishing loans and loans discounting paper mobilizing claims abroad, the bank making the loan assumes 30% of the risk and FNG likewise assumes 30%. The distribution of risk for FOPRODI loans is 33% for the bank and 67% for FNG. In other cases, the bad debt risk borne by FNG may amount to 50% or 75%. The percentage coverage given by FNG guarantees is often considered too low by beneficiaries, who complain of the additional guarantee requirements imposed by banks with regard to the portion of a credit not covered by FNG. All the same, it would be difficult to increase the percentage without creating risks of irresponsibility and wastage on the part of beneficiaries or the banks which finance them.

7.23 FNG's sphere of activity is limited to small and medium farmers, small and medium enterprises within the investment ceilings set by FOPRODI, projects funded by FOPRAM, and ventures receiving support from the Fonds de la Coopération et de la Mutualité. Although it is generally thought that a broader sphere of activity would undermine FNG's effectiveness, it may be useful to extend it to include coverage of certain export credit risks not normally covered by export credit insurance (see para. 7.38 below). This coverage is currently limited to operations for or on behalf of small and medium economic undertakings, but there could be merit in extending it to cover exports by larger enterprises, particularly in the manufacturing sector.

<u>Export credit</u>

7.24 In the coming years, the rate of growth of Tunisia's economy will depend to a large extent on what possibilities there are of mitigating the constraints imposed by the current account deficit. If they are to be lessened, not much reliance can be placed on import substitution, which -- given the small size of the domestic market -- could not be effected on a large scale without considerable losses of efficiency. Besides, prospects for petroleum-sector exports are not at all encouraging, as was mentioned in Chapter I. Exports of manufactured goods will therefore be fundamental, with the rate of development of the entire economy depending to a large degree on the growth in manufactured exports (see the Plan Execution Report).

7.25 Quite apart from its major share in GDP and in employment, the manufacturing sector increased its contribution to exports from TD 329 million in 1980 (34% of goods exports) to TD 595 million in 1983 (45.4%). These figures exclude food products. Exports were concentrated in the textile and chemical sectors, although the mechanical and electrical industries showed the highest growth rate (see Table A.7.4 in the Annex). API statistics also reveal that export projects (Law 72-38) had an average (1982/83) per-job investment cost of only TD 7,700 and that average investment per venture was TD 460,000. This indicates that export enterprises are for the most part of medium size.

7.26 Credit benefits are already one of the major means of fostering exports. They are justified not only for the reasons enumerated in para. 7.24 but also because exports do not command the type of protection afforded by the customs tariff or by qualitative restrictions favoring products sold on the domestic market (anti-export bias).

7.27 In examining the problems raised by export credit, distinctions have to be drawn among: (a) short-term prefinancing credit; (b) short-term credit for the mobilization of claims abroad (export credit proper); (c) medium-term export credit for the financing of exports of capital goods and engineering services; (d) export credit insurance; and (e) medium- and long-term credit for the financing of investments in export-oriented projects.

7.28 Short-term prefinancing credit: Export prefinancing credit is usually made available for a period of nine months. In 1984 the interest rate on this type of credit was 6-6.5% if it was rediscountable and 6.75-7% if not. In April 1985 a single rate of 6% was set for interest on rediscountable prefinancing credit, despite the increases of 1-1.5 percentage points in most of the other lending rates. Thus the interest rate advantages for export credits have increased. The new export credit rates (prefinancing and mobilization of claims abroad) are lower than all other short-term credit rates. Rediscountable credit is granted up to a ceiling set for each exporter, recently raised by the Central Bank of Tunisia from 10 to 20% of his annual export projections. For enterprises with continuous sales, rediscountable credit therefore covers a little more than 1.5 months of exports. The authorities have provided for the possibility of higher prefinancing credit on operations of a special nature or where financing needs are greater.

7.29 Since the recent increase, the quota of export prefinancing credit seems sufficient for a number of light industries. However, some enterprises say their prefinancing credit needs exceed the ceiling of 20% of their annual projections. To get their ceilings raised, they have to submit applications, which are judged on a case-by-case basis, with varying results. The export projections that constitute the basis for computing export ceilings are also often discussed case by case, which complicates the system still further.

7.30 It would be advisable to make the export prefinancing credit system even more simple and automatic. In light of the reasons detailed in para. 7.24, there is justification for maintaining these benefits by comparison with other types of credit. The following measures would be appropriate:

(a) To maintain the quota of rediscountable export prefinancing credit at 20% of the annual value of exports, but to extend its duration to 12 months. Quota and duration should be uniform for all exports except those involving capital equipment governed by the special rules mentioned in paras. 7.35 and 7.36 below. If these changes were made, the prefinancing credit ceiling would be equivalent on average to the value of 2.4 months of exports. It could be argued against this recommendation that the period required for production and preparation of exportable goods varies and consequently that prefinancing credit needs are not the same in all industries. This is a cogent argument, but as rediscountable export prefinancing credit is subsidized, enterprises with longer production cycles would receive higher subsidies if quotas or durations were not uniform. The way around this difficulty would be to fix uniform ceilings and durations on rediscountable credit and to cover the additional export prefinancing needs of industries or enterprises with longer cycles by making nonsubsidized credit available to them. On this basis, the prefinancing needs of all enterprises would be fully accommodated and the subsidy rate granted to each of them would be uniform.

(b) The 4% spread between the interest rate on export prefinancing credit and the base rate should be maintained; such a margin, on a one-year credit for 20% of the annual value of exports, would give a benefit of 1% on the value of exports, a modest figure when compared against the protection afforded those industries which dispose of their production on the domestic market.

(c) In order to avoid the uncertainties and complications that surround discussion of any enterprise's annual export projections, it might make more sense to use actual export figures for the immediately preceding six months as the basis for computation of the quota of rediscountable export prefinancing credit. 1/ Since the question would then be one of actual and not projected figures, it would be possible to curtail both discussions and anti-fraud precautions considerably. This suggestion could easily be implemented in the case of enterprises whose export activities are continuous and not likely to increase very rapidly. In the remaining cases (enterprises with irregular export activity, new export enterprises, and enterprises in the process of increasing their exports very rapidly), the present method of computing prefinancing credit ceilings on the basis of export projections would have to be retained, but as these cases are only a small proportion of the total, the automatic nature of the system would bring about a considerable improvement on average.

7.31 Short-term credit for the mobilization of claims abroad: At the time of the general interest rate increase in April 1985, the rates on short-term credit for the mobilization of claims abroad remained at the same level as export prefinancing credit rates. Thus they were not included in the general increase. At present, the rate on paper transactions abroad is 6% for credit of this type guaranteed by the Compagnie Tunisienne d'Assurance du Commerce Extérieur (COTUNACE) and 6.5% for credit not so guaranteed. Credit for the

1/ If the basis used for computation is six instead of twelve months of exports, the ceiling would need to be 40% of the half-year's exports to give results equivalent to those obtained with a figure of 20% of projected annual exports.

mobilization of claims abroad is exempt from the requirement for prior Central Bank authorization and rediscounting arrangements, and its rediscount is not subject to any ceiling. Duration of mobilization was recently increased from 90 to 180 days, and can be extended up to 360 days in cases justified by the exigencies of international competition.

7.32 The facilities for mobilization of claims abroad seem adequate. The system is already sufficiently automatic, but further extensions of the duration of mobilization through the Central Bank should be avoided; they add to the risk of adverse effects on the balance of payments by encouraging exporters to keep the proceeds of their sales abroad for longer periods so as to benefit from the higher interest rates available on the international market.

Medium- and long-term export credit

7.33 The system of credit for prefinancing and for the mobilization of claims abroad is not in line with the exigencies of international competition where capital equipment and engineering services are concerned. The time required to manufacture capital goods or design engineering projects is generally very long and cannot be financed on satisfactory conditions using the existing short-term prefinancing facilities. Likewise, the terms of payment extended to foreign buyers of these goods and services must often be between five and ten years.

7.34 In specific cases, the Central Bank will authorize medium-term credit to capital goods exporters so they can give their foreign clients up to seven years to pay. Made available on a case-by-case basis, this facility still does not fit into any system of general rules governing most medium- and long-term export credit. The seven-year term is not always enough to meet the demands of international competition; there is no meshing with prefinancing and the mobilization of claims abroad; and there is still no clear system of rediscounting rates and interest rates applicable during the prefinancing phase or over the term for which the foreign buyer is allowed credit.

7.35 The Sixth Economic and Social Development Plan emphasizes the need to introduce a better organized system of medium- and long-term credit in favor of capital goods exports. Although the Plan states that the proposed National Foreign Trade Bank will play a key role in this sphere, provision of the necessary medium- and long-term export credit facilities does not require creation of such an agency, which, anyhow, should be abandoned for other reasons (see Chapter III). They should be provided by the commercial and development banks, which would actually grant the credit, refinancing it later with the Central Bank or with a special fund established by the Government to supplement rediscounting possibilities (e.g. by refinancing that portion of an export credit granted for anything beyond seven years when the Central Bank will not do so).

7.36 Regulations should establish the minimum percentage of value that must be added in Tunisia if goods are to qualify for medium- and long-term export credit, in order to reduce the pressure of export credit on the country's balance of payments and prevent scarce subsidized resources being used to finance exports of products with a high foreign value added. Additional regulations should lay down an integrated procedure governing credit for prefinancing and the mobilization of claims abroad, and set close links with an export credit insurance system.

Export credit insurance

7.37 The Tunisian authorities have already established an export credit insurance system based on the Compagnie Tunisienne d'Assurance du Commerce Extérieur (COTUNACE). This mixed-capital company guarantees export credit against commercial and political risks and the effects of disaster.

7.38 As occurs in most other countries, the system will not cover manufacturing risks borne by the producer or exporter (bankruptcy, contract time overruns, defects in quality, etc.), though guarantees against risks of that type may be necessary to secure orders from abroad or obtain necessary financing from the banking system. Since it is of crucial importance for Tunisia's economic development that exports be increased, there would be justification, at least initially, for having FNG extend such guarantees to both SMEs and some large-scale concerns.

Credit for export-oriented investment

7.39 Medium-term credit from the deposit banks used to finance projects of enterprises whose objective is to export at least 80% of their production has the benefit of a preferential rate 8% if rediscountable and 8.5% if not. The rediscount rate applied is 6.5%. The advantages over other types of medium-term credit were increased at the time of the latest change in the interest-rate system (April 1985). These advantages are justified for the reasons set out in para. 7.24 and should be preserved or even amplified.

7.40 The following modifications are worth serious consideration:

(a) The percentage of total production beneficiary enterprises are required to export should be considerably less than 80%. For instance, a minimum of one-third might be set, with a provision that financing put into new export-oriented industrial projects would be eligible for special benefits in the same proportion as foreign market sales had to total sales. If these special benefits were available during an initial period -- six years, say -- the actual proportion of exports to total sales would have to be determined for each year. The resulting figure would then be applied to the total investment in order to determine the benefit available to export-oriented projects. This method would have at least two advantages: in the first place, it would be possible to benefit projects focused simultaneously on the domestic market and export activity, something not the case at present; secondly, it would preclude the risk of granting subsidies on the basis of over-optimistic export projections and would make it possible to adjust subsidies to actual export volumes. Account would, however, have to be taken of Tunisia's international commitments regarding export subsidies.

(b) Where the question is one of large-scale export projects, it would be more rational to replace the subsidization of interest rates on investment credit with subsidies computed as a function of value added at international prices. Because of the administrative difficulties involved (actual calculation of value added at international prices, monitoring of operations, etc.), this solution would be practical only for projects on a quite large scale. For the other cases, the method of preferential interest rates should be kept, but as proposed in Chapter V they should be based on subsidies granted independently of any rediscounting of the credit.

Equity capital financing

7.41 Since there is only a rudimentary stock market in Tunisia, it is not easy for private promoters of new ventures to find the equity capital contributions necessary for the establishment of new enterprises or the expansion of existing ones. To a large extent, this explains the major role played by the State so far in the establishment and development of new industries. The public sector has often been the only one able to marshal sufficient funds to launch larger-scale projects and is virtually alone in being able to convert borrowings into equity capital.

7.42 Development of the capital market and the emergence of private groups better able to finance their own ventures will help change this situation gradually. Direct investment from abroad -- including in particular that coming from other Arab countries -- may also have a major impact where equity investments are concerned. More than anything else, however, it is the recently created development banks which could increase available venture capital very significantly. The capital of four of these new banks (BTKD, BTEI, BTQI and STUSID) totals TD 320 million, which is there to be invested in holdings in the companies they finance. To put that amount in perspective, it can be compared to the total of the deposit banks' securities portfolios, which was TD 61 million in December 1983, and that of the other financial establishments, which was TD 109 million. This was an appreciable increase over December 1981, when the securities holdings of both deposit banks and other financial institutions totaled TD 91.7 million.

7.43 Development bank equity investments are generally tied to project financing (new ventures or expansion plans), their object being to complete the financing plan when the actual promoters of the venture lack sufficient funds of their own to subscribe the authorized capital in full. In principle, the banks take only minority holdings in the capital of companies they finance, since this enables them to avoid responsibility for the management of those concerns, something that would hardly be compatible with their role as bankers. All the same, in the case of projects the banks themselves promote, it may happen that as a group they turn out to have the majority holding; if not a desirable situation, it is sometimes inevitable, but the banks should take steps to ensure that such projects are independently managed.

7.44 Development bank equity investments are in principle temporary in nature. After a project has been implemented and operated successfully for some years, the banks prefer to sell their shares if they can obtain a certain profit. In other words, they are interested in rolling over their portfolios so as to be in a position to finance new projects. Over a period of five to ten years, the development banks could invest twice their total equity capital in holdings of this type.

7.45 The role of the banks in the companies they finance is rather a delicate one. Being shareholders, they are owners, and as such should take the decisions that will determine the future of those companies. As bankers, they wish to keep their distance so as to avoid responsibility for any errors that may jeopardize their loans. In practice, the conflict arises only when a project has been poorly appraised and is ultimately not justifiable. Generally speaking, careful supervision can prevent serious mistakes. On projects where several banks are majority shareholders, it is recommended that the supervision arrangements serve to the interests of all shareholders simultaneously.

7.46 Despite the importance of the contribution the development banks can make to increasing the supply of equity investment funds, it will be necessary to resort as well to other, supplementary measures if there is to be a really satisfactory supply of venture capital. Such measures should make it possible not only to attract additional funds but also to assist the development banks in rolling over their portfolios. At present, the prevailing low interest rates encourage promoters to borrow the maximum possible while putting up the least possible in the form of equity capital. In an indirect fashion, an increase in interest rates could prove an incentive for the investment of promoters' own funds. However, it is more important to provide direct incentives (or to remove existing obstacles) to equity capital investments (see Chapter X, which discusses the capital market).

7.47 Since the newer banks were set up, the question of the supply of equity investment funds has become a less urgent one. Nevertheless, it is unlikely -- and even dangerous to assume -- that more than 20 or 25% of risk capital needs can ever be financed by the development banks, so that there still remains the problem of the development of the share market. It would be no solution to oblige the development banks to invest in shares if that activity were to remain largely unprofitable and so make it unlikely they could sell their shares. In such circumstances, the Government, being the majority shareholder in the development banks, instead of being able to disengage from the production sector, would find itself more heavily involved in it than ever. On the other hand, if the Government were to make investments in shares profitable, the development banks would have a stake in developing the capital market in order to be sure of rolling over their own holdings.

Financing of small and medium enterprises (SMEs)

7.48 The financing of SMEs 1/ has traditionally been the domain of deposit banks and specialized development banks. Because of their nature and their financial, organizational and technical characteristics, the SMEs need diversified and regular financing, which should be based on continuous contact between them and their banks and not require long, complicated procedures. An extension of this is that evaluation and supervision of the SMEs can only be carried out by a bank in the same locality (travel being too expensive) and using summary reporting documentation. All these requirements explain why the

1/ According to the Tunisian definition, an SME is an enterprise in which up to TD 500,000 has been invested. A proposal to increase that ceiling to TD 700,000 is under consideration.

deposit banks have such an important role in this sphere of activity; thanks to their network of branches, they are very well placed to engage in the financing of SMEs.

7.49 The new development banks do not finance SMEs, since their policy is to finance only projects requiring investment of over TD 1 million. The only development bank with a history of financing SMEs is BDET, particularly where the required investment exceeds TD 300,000. However, over the last few years, the volume of BDET lending in amounts up to TD 500,000 has declined. On average, SME financing constitutes only about 20% of total BDET loan approvals, assuming that not all loans of less than TD 500,000 go to SMEs.

7.50 SME financing is actually not attractive to BDET, since the interest rate on these loans is set at 10.5 - 11%, while the average cost of new resources is between 9.5% and 10%. SME financing proves relatively expensive for the development banks, since promoters of this scale of project require a lot of assistance and close monitoring, while the cost of appraising and supervising a project is more or less independent of its size.

7.51 As noted in Chapter V, the commercial banks are required to invest at least 18% of their deposits in medium-term private credits. Nevertheless, in practice the major part of this proportion of their funds is used in the financing of large-scale projects, particularly in the public sector. From the standpoint of the deposit banks themselves, this is reasonable behavior, since large projects not only offer better guarantees but are also less expensive to manage.

7.52 Despite the importance of encouraging promoters of SMEs, it is clear that their financing by BDET and the deposit banks creates problems of an institutional nature. All the same, considering what a major contribution the SMEs make to the generation of employment, the development of entrepreneurial capacity and the growth of the national product, measures need to be taken to encourage and oblige both the deposit banks and BDET to be more active in financing them.

7.53 As far as the deposit banks are concerned, two measures are proposed, one in the nature of an incentive and the other obligatory. As an incentive, it is recommended that the deposit banks be granted a subsidy of 1% per annum on their portfolios of medium- and long-term loans to SMEs to compensate them

Table 7.8

BDET LOANS IN EXCESS OF TD 500,000 (1980-1983)
(millions of dinars)

1980			1981			1982			1983		
No.	Amount	% 2/	No.	Amount	%	No.	Amount	%	No.	Amount	%
94	10.25	32.0	110	15.12	24.9	98	14.40	22.9	76	11.34	28.0

2/ of total amount approved

for the proportionally higher cost of this type of lending (higher by comparison with the amounts lent): loan study and preparation costs, supervision costs, risk of default, etc. A loan of TD 50,000 would carry a subsidy of TD 500 per annum, which should prove sufficient incentive for the deposit banks. To be paid from the Credit and Investment Subsidy Fund proposed in Chapter V, it would increase the banks' spread but without any repercussions on borrowers.

7.54 The obligation proposed would be that of requiring the deposit banks to invest at least 7% of their deposits in medium-term loans to SMEs. This would be a subratio of the required proportion of medium-term private credits (see Chapter V) and would include loans to small, artisanal and trade enterprises, for which the present subratio of 2% would be eliminated. The objection might be raised that the deposit banks already have difficulties meeting the 2% requirement. There are three possible counterarguments to this position: (i) the new subratio proposed would cover both SMEs and small and medium farmers and not only small, artisanal and trade enterprises as at present; (ii) the subratio should be increased to 7% only gradually (e.g. by one percentage point per annum, commencing with 3%); and (iii) the subsidy proposed in para. 7.53 would increase bank interest in lending to SMEs and to small farmers, making it correspondingly easier to meet the new subratio proposed.

7.55 Considering that the commercial banks had a deposit base in the vicinity of TD 2 billion at the end of 1984, the requirement of 7% for medium- and long-term credit to SMEs would oblige them to engage in this type of lending up to a total of TD 140 million. Assuming the average duration of such loans to be six years, including one grace year, and assuming investment of about TD 130 million a year in SMEs (permanent working capital included), total commercial bank loans would finance approximately one third of annual investment in SMEs.

7.56 It is proposed that BDET and the other development banks should be given access to Central Bank rediscounting and that they should also receive the 1% subsidy proposed in para. 7.53 for deposit banks. The intention here would be to give the development banks a 3% spread on their lending to SMEs. In terms of the average cost of the resources development bank use in their lending to SMEs and of the rediscount rate, it is possible to determine the percentages of the total to be rediscounted within the rediscounting ceilings (e.g. if the average cost of normal resources were 10% and the rediscount rate were 8%, a rediscount percentage of 50% would reduce the resource cost of these loans to 9%; if the interest rate on the loans were 11%, the banks would have a profit margin of 2%, to which would be added the 1% subsidy; if the cost of normal resources were reduced to 9.5%, and if the rate on loans remained at the same level of 11%, it would be possible to obtain the same intermediation margin for the banks by reducing the percentage rediscounted to one-third). The percentage of portfolio rediscountable with the Central Bank could be set for periods of six months or a year.

7.57 The measures proposed above would pave the way for healthy competition between the development banks and the deposit banks. The SMEs would have the benefit of a broader range of financial services, which would ensure their growth. At the same time, the definition of what an SME is should be reviewed. The easiest course would be to accept the API definition (see Decree 78-578 concerning FOPRODI). In thes circumstances, it seems reasonable to increase the total investment figure to TD 700,000 (as recommended by API) or even to TD 1 million. While FOPRODI provides incentives for promoters to invest in new projects, the proposed measures would give the banks an incentive to lend to SMEs. The acceptability of projects within the ratio required of deposit banks for computation of the 1% subsidy, and the rediscounting facilities to be allowed the development banks, should be established according to simple criteria to be formulated by the Central Bank.

Chapter VIII

THE INSTITUTIONAL FINANCING OF HOUSING

A. The Housing Finance Institutions

8.01 During the Fifth Plan (1977-81), housing investment amounted to TD 829 million. It was about 27% of construction investment and reached 15% of gross fixed capital formation, but it was low in terms of GDP, averaging 4.4%. The institutional housing finance sector provided 52% of gross financing and 41% after deduction of borrowers' repayments during the period. The main sources of financing were CNEL (33% of net financing for housing investment), the Government budget and the two social security funds (10% each), the commercial banks (8%), and FOPROLOS (3%). Tunisia's main housing finance institutions are described below and key data are summarized in Table 8.1. 1/

8.02 The Caisse Nationale d'Epargne-Logement (CNEL) is an autonomous public savings and loan fund established in 1974 to introduce the contractual savings scheme to Tunisia. It offers four- or five-year savings contracts earning 4% interest (plus a 2% Government-financed premium) to its participants, who thereby qualify for loans (equal to two times their accumulated savings) for new housing purchase or construction and enlargement of existing structures. The interest rate charged is 5.5% minus 1 percentage point of government subsidy and the maturity is 10 or 15 years depending on the term of the savings contract. CNEL also grants advance loans ("prêts anticipés") to participants who want to borrow up to two years before their savings contracts mature; it also prefinances housing construction by public and private developers. By mid-1984 it had executed about 142,000 contracts totaling TD 275 million in savings and had made 27,580 loans totaling TD 169 million, thus becoming in ten years the primary housing finance institution.

8.03 The Caisse Nationale de Retraite et de Prévoyance Sociale (CNRPS) is the public sector's social security and pension fund. Since 1976 it has built and managed rental housing (stock of 1,160 apartments valued at TD 15.5 million at end 1982) and has made about 1,600 loans per year to its affiliates for site and house acquisition and construction. CNRPS plans to expand its stock to 3,600 rental units during the Sixth Plan (1982-86), involving TD 50 - 55 million of capital expenditure, a goal which does not seem feasible given its projected cash flows.

8.04 The Caisse Nationale de Securité Sociale (CNSS) is the counterpart of CNRPS for the private sector. It too develops rental housing but lets a subsidiary, SPROLS, manage it. Since 1981 it has made about 900 loans amounting to TD 2.5 million per year to its affiliates, 80% of which is for house enlargement and the rest for site and house acquisition as well as for complementing CNEL savings.

1/ A more detailed analysis can be found in the Institutional Housing Finance Sector Review (Report No. 5199-TUN).

Table 8.1
TUNISIA: HOUSING FINANCE INSTITUTIONS

Institution	Role	Activity Data
CNEL. Savings and loan (Caisse Nationale d'Epargne-Logement) Established: 1974	- mobilizes savings - makes mortgage loans to savers - Provides prefinancing	- 142,000 contracts; TD 275 million up to mid-1984 - 27,600 loans; TD 169 million up to mid-1984 - 45,400 units; TD 193 million up to mid-1984
FOPROLOS: Workers' Housing Fund (Fonds Social pour la Promotion du Logement des Salariés) 1978	- financed by proceeds of 2% payroll tax - makes mortgage and personal loans to SMIG earners - provides prefinancing for developers	- TD 83 million collected in in 1984 - 9,800 loans; TD 18.5 million up to 1982; TD 33.2 million up to 1984 - 9,900 units; TD 19.9 million up to 1981
CNRPS: National Social Security Fund (Caisse Nationale de Retraite et de Prévoyance Sociale) 1976	- makes mortgage loans to members for plots and for home purchase and construction - finances, owns, manages rental buildings	- 1,600 loans p.a.; TD 37.7 million together with CNSS during Fifth Plan - TD 20.9 million investment during Fifth Plan - rental housing stock: 1,200 at end 1982
CNSS: National Social Security Fund (Caisse Nationale de Sécurité Sociale) 1982	- makes mortgage loans to members for plots and home purchase - finances and owns rental buildings	- 1,400 loans; TD 2.4 million between Jan. 1982 and Aug. 1983 - TD 23.9 million investment during Fifth Plan
SPROLS: CNSS subsidiary (Low-Cost Housing Corporation) 1977	- manages CNSS' rental buildings	- TD 730,000 collected in rents in 1982
Commercial banks (10)	- grant 7-year housing loans	- TD 31.3 million (gross) in loans during Fifth Plan
State budget:	- finances low-cost programs - provides subsidies to individuals and to institutions	- TD 45 million during Fifth Plan - TD 37 million during Fifth Plan - TD 19 million to SNIT, AFH AFH and FNAH during Fifth Plan - Total housing assistance: TD 101 million during Fifth Plan
FNAH: Housing Improvement Fund (Fonds National pour l'Amélioration de l'Habitat) 1956	- makes housing improvement loans to individuals and municipalities	- 4,800 dwellings; TD 2.6 million - 9,500 dwellings; TD 2 million during 1980-82

8.05 The Société de Promotion de Logements Sociaux (SPROLS), established in 1977, fell short of its Fifth Plan production targets for a variety of reasons (delays, high standards, cost increases, and ambitious targets), but has not lowered its sights for the Sixth Plan. Since these investments put a heavy burden on CNSS and its retirement affiliate, CAVIS, there is no commitment beyond the Sixth Plan target, which would leave up to 8,000 families on SPROLS' waiting list. Eligibility criteria are seniority of membership in CNSS, family size of applicant and affordability of the rent, which should represent about one fourth of the beneficiaries' median income.

8.06 The Fonds Social pour la Promotion du Logement des Salariés (FOPROLOS) is the workers' housing fund, funded by a 2% levy on all payrolls. It extends subsidized housing loans to workers earning between 1 and 2 times the minimum wage (SMIG), and small personal loans to workers earning between 2 and 3 times the SMIG. FOPROLOS is managed by CNEL, which requires borrowers to open a CNEL savings account and charges one-time fees of 1% on loan disbursements and 2% on collections. While it fell short of official lending targets, FOPROLOS has performed better in prefinancing the construction of dwellings, although most of them have been medium-priced rather than low-cost units.

8.07 Commercial banks. Although allowed by the regulations to lend for housing (2% of deposits), the ten commercial banks do not favor this activity because their loan maturity is limited to seven years and only half of the loans are discountable with the Central Bank. Since there are no incentives, the 2% ratio between the banks' deposits and their housing loans is not met, standing at 0.6% at the end of 1984. Despite their comparatively hard lending terms (interest rate recently raised from 10.25% to 12.65%) there is a heavy demand for these loans from high-income groups, but most loans are made to employees of prime corporate clients.

8.08 Government budget. During the Fifth Plan the budget financed over 12% of all housing through loans (45%) and subsidies (55%) to institutions (34%) and individuals (66%). Among the latter, the largest share goes to the Rural Housing Program's beneficiaries. The construction bonus was abolished in 1980 when it became evident that only a small fraction of its beneficiaries were low-income households. Although CNEL participants are also middle-income, they are receiving an increasing amount of interest subsidies. The Government currently grants subsidized loans to beneficiaries of two programs: the "rehousing" of shanty and slum dwellers in the urban fringes and the rural housing program, but few such beneficiaries repay their loans which thus become de facto grants.

8.09 The Fonds National d'Amélioration de l'Habitat (FNAH) is administered by the Ministry of Housing. It makes loans to individuals for individual home or whole neighborhood improvement, with a recent focus on the latter. Its resources are a share of the rental value tax and of the loan repayments collected by a commercial bank against a 1% commission.

8.10 Corporate social funds. A number of private and public sector companies offer financial assistance to their employees, which greatly assists the operation of the institutional housing finance system. Lending terms are generally soft (as low as 1% p.a. and up to 20 years) and the amounts are substantial (up to TD 15,000).

B. Housing Finance Instruments

Site acquisition

8.11 AFH, the housing land developer, extends credit for a serviced plot in exceptional circumstances. Only two institutions finance site acquisition -- the social security funds, CNRPS and CNSS -- and they serve only their affiliated members. Their combined volume is very small, given the bottleneck in developed land availability in Tunisian cities. Although the income distribution of members of the two funds differs considerably, both groups purchase plots in roughly the same price range (average about TD 3,000), which confirms both the limited availability of serviced plots and the small loan amounts. Financing terms at both windows are very soft (interest rates of 3% to 6% for CNRPS and 4% for CNSS). CNRPS offers better conditions in general; while they are more costly to service over the life of the loan (15 years compared to 10 for CNSS), they carry lower monthly payments which permits access to lower-income groups. Moreover, CNSS' somewhat harder terms result in larger down payments on average (33% higher), which demands a greater saving effort. The median debt service ratios are 12.9% and 9.3% for CNSS and CNRPS borrowers, respectively, indicating that loan terms for site acquisition are affordable for most borrowers. The cost of current housing, however, should be factored in to obtain a realistic assessment of total housing expenditure and consequently the real risk associated with this type of financing.

Home purchase/construction loans

8.12 There are nine institutional windows that provide mortgage financing: two each at CNEL, CNRPS, CNSS and FOPROLOS, and one at commercial banks. CNEL dominates housing finance; the other windows together (commercial banks, CNRPS, CNSS, FOPROLOS) provided almost as much net mortgage financing as CNEL during the Fifth Plan, accounting for 22% compared to CNEL's 23% of institutionally financed investments. These windows, through loans that complement CNEL's, also play a valuable role in lubricating the system and are essential for its smooth operation.

8.13 The median monthly income of beneficiaries in those groups predictably covers a very broad range (TD 112-576 in 1983) 1/ but at least 25% of borrowers at the CNEL/CNSS cofinanced window had incomes below the minimum wage. At these income levels, it is hard to see how a home purchase could be a realistic option for low-income families and how much the concessional terms are encouraging them to borrow beyond their ability to save and repay the loans. Although windows clearly overlap in terms of income distribution, they cater to three broad groups: (i) up to twice the minimum wage for CNSS; (ii) a group above that and up to TD 575 of monthly income for CNRPS and CNEL; and (iii) a very high income group served exclusively by commercial banks.

8.14 Housing prices in 1983 ranged from TD 1,480 to TD 86,233 but the ratio of these extremes (48:1) is markedly lower than that of incomes (136:1). More important, the proportion of houses priced above TD 18,000

1/ These data are derived from a sample analysis of 800 borrowers in 1983 (see Institutional Housing Finance Sector Review, Chapter III, mentioned in the note to para. 8.1 above.

(mission estimate of high-cost unit) is considerable — 91% for commercial banks and at least 27% for CNEL, CNRPS, and CNSS. Since these last three windows have relatively low loan ceilings (TD 8,000 maximum), buyers of high-priced houses must finance their purchases heavily out of their own assets and also by pooling loans from various sources. Only 56% of CNEL's loans finance units costing less than TD 13,000, which is the maximum price eligible for construction prefinancing that CNEL imposes on housing developers. For higher-cost units, developers have no readily identifiable source of financing other than prepayment by beneficiaries. Only one window (CNEL/CNSS cofinancing) consistently finances housing at less than TD 15,000 but its volume is limited, evidence of the critical lack of financing for lower-cost housing.

8.15 Loan amounts, too, vary widely (average from TD 1,231 to TD 10,975), but all institutions tend to grant the statutory maximum loan. Compared to housing prices, these loans leave a large gap to be financed by the recipients, from 45% to 80% of the price depending on the window, equivalent to 19 to 50 months of income. Only CNEL/CNSS joint loans and CNEL advance loans leave modest gaps (6% to 16%). This shows that as cofinancing is institutionalized or the savings requirement is financed, the financing gap narrows dramatically. Whether this gap is due to unrealistic loan ceilings, insufficient debt service capacity (affordability), or a resource constraint is not clear; but as pointed out above, borrowers are known to convert other assets into investment in housing and pool several loans from different sources to finance their purchases.

8.16 Lending terms vary widely as regards both interest rates (3% to 12.65%) and maturities (6 to 15 years), and there appears to be little economic justification for this wide range, even on the grounds of social equity. Indeed, analysis of windows serving a wide range of incomes shows that comparable loans have lower monthly payments as income rises. There is clearly an inverse cross-subsidization, with low-income borrowers paying more, relatively and absolutely, than higher-income borrowers for the same financial service.

8.17 Median monthly housing loan payments range from TD 22 to TD 193. In terms of income, these amounts translate into proportions of 12% to 20%, which is well within an acceptable standard (say 25%). There are two exceptions to this: commercial banks with 32%, which is becoming more and more a typical ratio; and the CNEL/CNSS cofinancing arrangement (51%), which represents a considerable credit risk. It is impossible to know with the currently available information how much joint financing is taking place; based on the assumption of 30% financing (that is, setting aside current ceilings), debt service ratios would be much heavier and insupportable for some groups (median as high as 54% for CNSS loans and 72% for commercial banks). On the other hand, CNEL loans would be relatively unchanged (19.5 to 22.8%), mainly because the gap is covered by contractual savings.

Rental housing

8.18 The Government also supports rental housing programs to enable low-income families to save the down payment necessary to buy a house. Rents, however, are set so low that they do not come close to covering the capital and operating costs of CNRPS and CNSS. Increases in rents should be envisaged to narrow the financial advantage of rental over purchase as well as to increase the return on investment for the two institutions involved; rents should be such that similar payments would service substantial housing loans. There are long waiting lists for CNRPS and SPROLS rental housing, and more recently CNEL savers have been cancelling their savings contracts to switch to renting. There is no income criterion for access to rental housing, which should be remedied to provide a basis for the equitable distribution of units.

C. Performance of Mortgage Lenders

CNEL

8.19 Notwithstanding its success in attracting household savings, CNEL is not a housing bank, since it neither serves a wide spectrum of incomes nor offers a broad range of housing finance services. Although the primary motives of CNEL savers to open contractual savings accounts seem to be access to a housing loan and the soft terms available, more of CNEL's lending thus far has been on the basis of a no- or partial-savings requirement, rather than on its contractual savings programs. Moreover, borrowers who satisfy their savings requirements have to wait sometimes as much as two years longer than the four or five years required by their contracts. Few of CNEL's subscribers take the five-year savings option, which entitles them to a longer maturity and lower debt service. This suggests either a marketing bias by CNEL, a consumer preference for shorter savings programs (with the possibility of converting to an advance loan), or irrational behavior, which seems unlikely. Currently, amounts withdrawn because of account closings represent a decreasing proportion of total new savings because closings seem to have topped out in recent years, but it takes annual deposits in two new accounts to offset a closing. If more depositors were to close their accounts simultaneously because of the longer waiting periods, CNEL would conceivably be faced with a serious cash-flow problem.

8.20 The success of the savings mobilization effort -- combined with inadequate land development that resulted in slow housing completions -- had already caused a considerable backlog of mature savings contracts in 1982 (18,000), which could more than double by 1986 (48,000). At the 1982 lending rate, and assuming no change in current policies, it would take CNEL 10 and 27 years, respectively, to eliminate the actual 1982 and projected 1986 backlog. Clearly, CNEL should be doing all it can to overcome these bottlenecks by finding effective solutions. Since the cause of the problem seems to be a scarcity of product (serviced sites and homes) rather than of means (funds), CNEL should be contributing more to the upstream financing of land development and housing production. It should be encouraged to consider additional financing of this kind, even if it requires a modification of its charter. CNEL's recent initiative to create a savings and loan scheme for site acquisition should also be supported, especially if the proposal is modified to permit prefinancing of land developers and then, when work is completed, consolidation of such prefinancing into mortgage loans for plot purchasers. To stimulate real estate development, CNEL should also continue its efforts to involve private developers who apparently are not only discouraged by less favorable terms than public sector developers receive, but also have to contend with heavy administrative paperwork.

CNRPS and CNSS

8.21 Although CNRPS and CNSS are social security and pension funds, they have made a useful contribution to housing finance. The main question about their lending activity concerns their permanence. First, they contend that their primary objective is to fund social security benefits and pensions, their involvement in long-term (housing) lending being a temporary activity undertaken at the Government's request. Second, continued lending would undermine their rental housing construction programs, to which they are deeply committed despite their heavy burden and debatable justification. Third, without additional funding CNRPS and CNSS will face shortfalls of surplus resources, forcing them into lending cuts, especially in long-term real estate loans, unless they can refinance their mortgage loan portfolio.

8.22 These windows must be retained, since they provide a most useful service and cater to specific income and occupational groups. However, there is a need for major changes in the funding of the housing sector by CNRPS and CNSS. There must be a reduction of the conflicts between the requirements of housing programs and the basic purpose of these funds, which is to pay out social security and pension benefits. In future, the social security agencies will be obliged to disburse pension and social security payments that are much higher in real terms. At that time they are almost sure to be faced with major financial difficulties because a large proportion of their assets will have been invested in housing loans and in rental housing, producing sharply negative real rates of return. In other countries where the experience has been similar, the social security system has been compelled either to call upon major financial support from the government budget or to reduce drastically its real transfers to beneficiaries. It is highly unlikely that problems of this kind can be avoided in Tunisia, but they should be limited insofar as possible by: (i) decreasing interest subsidies on housing loans made by CNRPS and CNSS, and (ii) improving the rate of return of the investments that these agencies make in rental housing, or eliminating such outlays. One solution might be to merge the lending activities of CNRPS and CNSS into the housing bank proposed in paragraph 8.46 below, while still requiring them to commit funds on a multiannual basis.

FOPROLOS

8.23 FOPROLOS is the only housing finance institution that has a steadily growing resource base thanks to its 2% payroll tax, which is a tremendous asset from which to launch financing programs. However, it has been dissipating its strength by spreading itself thin on loans to complement CNEL savings. Its loans carry long grace periods (up to 15 years), which the small loan amounts (up to TD 528) do not justify. If this lending window is to be maintained, the grace period should be cut down to five years and the repayment period limited to three years. For those earning wages equivalent to twice the minimum wage (SMIG), the marginal debt service ratio would then be less than 6% of income, assuming an 8% p.a. increase in the SMIG and an unchanged 4.5% interest rate. This would be affordable for borrowers and would cut the recovery period for the institution in half. In the early 1980s it was decided to increase the share of FOPROLOS funds going into construction financing. Although it contributes to housing supply, this approach has two flaws: (i) it underutilizes resources for short-term financing with no link to long-term lending; and (ii) it finances more expensive units and thereby discourages the production of lower-standard housing. FOPROLOS, therefore, should focus on developing its capacity to finance only low-cost dwellings with modest standards and revise its lending terms to improve replicability and ensure affordability. The interest rate on loans to those earning 1.5 times the SMIG should be raised to at least 5.5%, and personal loans to those earning up to three times the SMIG should be eliminated. FOPROLOS might also consider using excess funds from construction financing repayments and mortgage loan payments to cofinance low-cost rental housing, but only if their rate of return is adjusted.

Commercial banks

8.24 The contribution of the commercial banks to housing finance has been meager, since the seven-year limit on maturity and high interest rates make their loans affordable to only a few people. Moreover, commercial banks have not actively pursued mortgage loans, which are illiquid and only partially rediscountable at the Central Bank; nor has the Government offered them any incentive to do so -- the 2% housing ratio has seldom been fully enforced. It would make sense to encourage greater involvement by the commercial banks in housing finance in future years to address the growing need and offset likely cuts in government subsidies. Their involvement might include expanded rediscount facilities for institutions facing temporary shortages of funds. To reduce pressure on the Central Bank, the possibility of refinancing by a specialized institution (e.g., CNEL if it continues to have surplus funds) might be considered. Such a system would be a first step toward setting up a formal secondary mortgage market in the medium term.

D. Review of Housing Finance Mechanisms

Principal problems

8.25 The analysis in the foregoing chapters underscores the need to solve a number of problems in the present housing finance system:

- high costs and distortions resulting from interest subsidies;
- losses suffered by the social security agencies and inequitable distribution of the benefits of renting the housing they fund;
- scarcity of accessible building sites;
- fragmentation due to the proliferation of housing finance windows;
- rigidity of the lending terms of most windows;
- accumulation at CNL of a substantial number of matured savings contracts.

8.26 Given the problems facing the housing finance system, the strategy alternatives for the Tunisian authorities are either (i) to retain the present structure while gradually introducing improvements in the system, or (ii) to reform it through radical change. The first strategy assumes the strengthening of CNEL with changes in its present structures, and correction -- at least in part -- of the problems listed in the preceding paragraph. The second strategy would require the creation of a new and expanded system of housing finance and the operation of a secondary mortgage market. The sections below deal with these two strategies in the following manner: (i) they present recommendations on the problems mentioned in paragraph 8.25; (ii) they analyze the institutional changes that would be necessary in a more radical reform of the present system.

Interest subsidies

8.27 The financial instruments offered by the housing finance institutions should be modified with a view to increasing their return on assets without lessening their affordability to beneficiaries. Interest rates in housing finance have not been adjusted since they were first set eight years ago, even though they have not kept pace with inflation and are negative in real terms.

8.28 It is difficult to estimate the real cost of housing finance subsidies, but they are known to impose a heavy burden: (i) on the government budget; (ii) on the financial structure of the social security agencies; (iii) on CNEL depositors whose accumulated savings pay them a markedly negative real rate of interest while they are waiting unwillingly after their savings contracts have matured. Apart from its high cost, the interest subsidy on housing loans often has unwanted redistribution effects.

8.29 The interest subsidy to CNEL (2% on deposits, 1% on loans) benefits its affluent clients more. Reducing the first of these two subsidies would have little impact on the borrowers' demand for financing, but a significant impact on the government budget (estimated at around TD 32 million between 1985 and 1994). Similarly, while the subsidy element of the rural housing program is not even essential to achieve affordability, its loan element is characterized by poor recovery. If subsidies are to be maintained, given their present ineffectiveness they should be quantified and reserved for specific low-income groups, for example those below 1.5 times the SMIG.

8.30 Accordingly, interest rates on housing loans should be raised. The rate should be at least 8%, a level which will continue to demand substantial subsidies. The rate of subsidy should be tied to the cost of the house financed (cost per square meter and total cost) so as to favor low-cost housing. In addition, this would indirectly help to earmark subsidies for low-income families. One major objective would be to lower the overall direct and indirect cost of subsidy facilities. Better use could be made of subsidies by granting them to low-income households or to such institutions as AFH and SNIT, on the condition that they be used for lower-standard housing projects.

8.31 Although doubling the nominal interest rate may appear to be a drastic and impracticable measure, it can be made quite affordable as measured by the percentage of monthly income allocated by the borrower for repayment, if offsetting measures are taken concurrently. The loan amount should be raised to 70% of the cost of the housing and the maturity should be 12 years for site acquisition loans and 20 years for house purchase or construction loans. Graduated payments should be offered to borrowers whose debt service ratio initially would be over 30% with fixed payments. However, since this mortgage instrument carries a greater default risk then comparable level-payment loans, a realistic rate of graduation (e.g., lower than recently observed income growth rates) should be made available to avoid the negative amortization effect.

8.32 Similarly, the introduction of graduated payments and/or longer maturities would make the proposed new FOPROLOS loan ceiling (TD 4,800) affordable even after almost doubling the interest rate to improve replicability.

8.33 There would be justification for a modest subsidy (say 1%) on loans made under the housing savings system, to increase the attractiveness of this mechanism vis-à-vis loans for which there are no formal requirements of prior saving.

Rental housing investors

8.34 Investment by CNRPS and CNSS in rental housing started at the request of the Government on the grounds that they had unutilized long-term investment funds. This may be unrealistic, given not only the performance of such funds around the world, but also the illiquidity of these investments, especially since they are money-losing activities. There is no evidence that the program is meeting any social objectives in terms of reaching low-income families. CNRPS and CNSS do not compute the internal rates of return (IRRs) of their rental investments, but they are estimated to be no more than 2% over a 30-year life. Such low returns do not allow any replicability, since the purchasing power of repayments received by CNPRS and CNSS is being rapidly eroded by inflation. Their loans, moreover, yield much higher returns and reach many more beneficiaries than their rental investments. It is difficult to see the rationale for CNSS and CNRPS investing in rental housing at maturities that are double and with yields that are a quarter of those possible for development banks, for example. Furthermore, although the targeted beneficiaries are similar, the default risk is higher for renters than for borrowers. In any case, the required action on rents (i.e., tripling current levels) to produce a reasonable return on present investment (which would also require rent decontrol) is likely to be socially unacceptable without offsetting measures for low-income tenants. For all of these reasons, CNRPS's and CNSS's new rental housing programs should be reduced, as proposed in paragraph 8.22, and the existing rental housing stock transferred in the form of properties for rent with possibility to buy, unless the rate of return on such investments can be raised to at least 7%. If these programs are retained, family income should be introduced as one of the basic selection criteria.

Site acquisition loans

8.35 A major bottleneck in the housing finance system is the shortage of affordable serviced sites, and thus of housing. Despite its primarily physical nature, this bottleneck may well be linked to the financial package question. The problem could be mitigated considerably by (i) providing construction financing for developers of appropriate land improvement and home building projects, to be linked to permanent financing for purchasers, and (ii) lowering physical standards.

8.36 CNRPS and CNSS are the only two windows offering financing for site acquisition, but they regard such loans as temporary financial assistance provided to their affiliates, which in itself constitutes a bottleneck. They provide a useful service and lending procedures are adequate, except for application processing time, which should be reduced to not more than 30 days. The current lending terms offered by CNRPS and CNSS should be improved, simplified and standardized. Interest rates should be raised to 8% p.a. and maturities aligned up to 12 years, with periodic reviews; the maximum loan might be adjusted to TD 4,000, with an indexation provision to keep the windows effective. Graduated payments should be offered to borrowers whose debt service ratio would be over 15% with fixed payments. Studies show that all these measures combined would be affordable to at least half of the borrowers, assuming that there are no major changes in the present pattern of income distribution.

8.37 In addition to these windows (which are limited but have demonstrated that they serve their purpose well), the authorities should also consider providing a broader range of land financing schemes through some other institution (preferably CNEL, as mentioned in paragraph 8.20) to alleviate the current bottleneck in AFH. A site savings and loan scheme for housing on the model offered by CNEL could tap the savings capacity of households which could then afford larger down payments. To be attractive, this new scheme might offer a loan equal to 70% of the current land price, with a maximum of TD 4,000, adjustable once a year to avoid penalizing households that save voluntarily. Commercial banks should be encouraged to make medium-term loans to private developers for the purchase or repayment of land for residential construction. Interest rates and maturities should also be aligned with those of the existing windows.

Fragmentation of the housing finance system

8.38 The housing finance system's failure to fully meet the needs of borrowers has resulted in the appearance of a large number of land and home finance windows in addition to CNEL. While these windows have narrowed the financing gap, they have caused fragmentation of the system, operating with no coordination or centralized credit risk monitoring.

8.39 To overcome this fragmentation and allow resources to be used better, it would be necessary to:

- provide for greater uniformity in the conditions of housing loans made by the different institutions (interest rates, maturities, ceilings, etc.);

- ensure better coordination of the lending activities of the housing finance institutions, particularly as regards the pooling of several loans to finance the same house.

Rigidity of lending conditions

8.40 Although low interest rates give the impression of soft terms, the lending conditions of most windows are still rigid. Loan amounts have no upward flexibility and maturities are shorter than for mortgage loans made by housing banks in other countries. Here too, however, there are signs of change, as loan committees begin to show some flexibility and responsiveness to individual needs. Thus, although there is fragmentation and rigidity in the system, there is also some accommodation.

8.41 One of the most serious problems of rigidity is that stemming from the limitations imposed by the loan ceilings of CNEL and the social security agencies despite the continuing upward movement of housing prices. To offset the loss of purchasing power, CNEL has allowed more and more savers in recent years to shift from one contract ceiling to a higher one in order to apply for a larger loan. However, because this practice implies that the prior savings requirement must be met anyway, large additional deposits bunched in a short period are sought from savers. As this is often unfeasible, they have to borrow elsewhere to meet the savings requirement before CNEL will disburse their loan. This is counterproductive because in most cases no net prior savings have been generated. The practice should, therefore, be reviewed with the aim of eliminating the delayed savings requirement, while retaining the flexibility offered to the participants to upgrade their contracts. The last adjustment of the savings contract ceiling from TD 10,000 to TD 13,000 was made in early 1981. Another adjustment is due because construction costs have risen by about 30% between early 1981 and mid-1984. It is estimated that a new ceiling of TD 17,000, for example — which corresponds to the lower 75% of the house price distribution observed in 1973 — would bring TD 2.8 million of additional savings per thousand contracts during each of the following four years. Ceilings on loans made by FOPROLOS and the social security agencies should also be raised. The FOPROLOS loan ceiling should be increased to TD 4,800 at 1983 prices, with annual index adjustments.

8.42 A number of steps are needed to solve the other problems of rigidity:

(a) introduction of more attractive mechanisms for financing site acquisition, as proposed above in paragraphs 8.34 to 8.36;

(b) extension of loan maturities (to at least 20 years in most cases);

(c) elimination of the additional savings requirement when CNEL contracts are updated;

(d) generalized application of the 5% proportion of CNEL bonds that commercial banks must subscribe and earmarking of the funds thus raised to purchase CNRPS and CNSS mortgage loans (to encourage them to remain in the system), or to temporarily refinance housing loans made by commercial banks;

(e) development of noncontractual housing loan facilities financed by voluntary savings schemes, paying higher incentive rates than those available on housing savings, and by funds borrowed on financial markets.

8.43 CNEL has demonstrated the effectiveness of contractual savings in mobilizing resources and is clearly satisfied with the loan mechanisms. Apparently, contractual savings deposits are influenced more by incentives (a housing loan on attractive terms) than by the interest paid on deposits. The intrinsic weakness of the system is the difficulty of forecasting housing prices and drawing up realistic savings contracts based on the forecast; upon maturity, many savings contracts are insufficient to finance housing.

8.44 In the long run the survival of the CNEL system will be threatened if it continues to keep its depositors waiting several years for their loans after their savings contracts have matured, and if depositors continue to earn only 6% interest on their deposits (including the 2% premium) while house prices increase by over 10% a year. In such a situation the savings accumulated by a given depositor at CNEL represents a decreasing proportion each year of the price of the home that he intends to buy. To solve this critical loss of purchasing power problem it will be necessary: (i) to expand the supply of housing and plots of the types desired by CNEL savers; (ii) to pay a higher interest rate on savings deposited with CNEL during the involuntary waiting period after maturity of the savings contract. The first of these solutions has already been discussed. As for the higher interest proposed in (ii), the rate paid should be equal to that on savings accounts at over two years at CENT (currently 8.75%). It is quite likely that, even if earning interest at 8.75%, the value of accrued savings, including capitalized interest, will not keep pace with the upward movement of house prices. Nonetheless, the losses incurred by CNEL savers will be lower than at present and the outlook for developing the housing savings system will be much brighter if there is an increase in the interest rates paid during the involuntary waiting period following maturity of the contract.

Strategy for a more radical transformation of the housing finance system

8.45 A more ambitious strategy calling for radical transformation of the housing finance system would be twofold: (i) to create a new, broader housing finance system, and/or (ii) to develop a secondary mortgage market. It is based on the idea that although the present system is only eight years old, it was defined too narrowly at the beginning and it is time to rectify shortcomings and recognize several fundamental trends of the 1980s (for example, the involvement of social security funds in lending for housing and the large number of exceptions granted in the present contractual savings and loan system). These trends point to a desirable downplaying of CNEL as the sole mortgage lender in its present form. A more broadly based system of housing finance is essential to encourage greater involvement by institutions such as insurance companies and commercial banks, which have shied away from residential real estate financing. Moreover, a country like Tunisia, whose financial sector is relatively well developed, can no longer rely exclusively on a single type of mortgage instrument if the strong underlying demand for housing credit is to be met.

8.46 Tunisia has ten commercial banks and eight development banks, but a full-service housing finance institution to finance what amounts to some 15% of the country's total investment is still lacking. CNEL's range of activity is too narrow at present to qualify it for the role. On the lending side, it does not finance site purchase, upgrading of existing housing stock, or acquisition of old houses, mainly on the grounds that any new lending facility should be based on a specific contractual savings scheme, which takes time to develop. CNEL has also declined to invest in rental apartment construction. On the resource mobilization side, it has not tapped the financial market to a sufficient degree because it has not needed it.

8.47 The broadened housing finance system would be based on a full-service mortgage bank, which preferably would be a radically redefined CNEL. This institution would have many of the functions as in the first strategy, the essential difference between the two being the approach to resource mobilization. Contractual saving would remain, but the emphasis would be on

(i) tapping voluntary savings to stabilize aggregate savings, and (ii) raising funds on financial markets, for example through bond issues. This would have the advantage of not being linked directly to future housing prices, making for a better matching of maturities in sources and uses of funds, and contributing to the development of the Tunisian capital market.

8.48 The housing finance sector is to a large extent separate from the rest of the financial sector. The main links are Central Bank rediscount facilities available to commercial banks and the subscription of CNEL bonds by commercial banks (5% ratio). Given the amount of loans outstanding and their nature (funds are tied up for 10 to 15 years), there is now a need to create a medium for linking the mortgage market more closely to the other financial markets. This might be achieved by having the housing bank issue mortgage-backed bonds and through a secondary mortgage market, although the latter step is probably to be envisaged for the longer term.

8.49 Because they would be backed by mortgages, housing finance bonds could carry a yield lower than that for industrial bond issues, but the tax incentive should be the same. To make the bonds liquid, they should be listed and traded on the securities market. To attract the interest of financial intermediaries, it would be desirable that these bonds be accepted by the Central Bank and the Ministry of Finance as statutory investments for the insurance industry, as well as eligible investments for development banks.

8.50 With a secondary mortgage market, the primary lender would cash a portion of its portfolio to improve its liquidity position; this portion would then be packaged and offered to institutional or individual investors, who would find a use for their surplus liquidity. The secondary market would thus be able to serve as a conduit for the entry of institutional investors, such as life insurance companies, into the mortgage market, which they would not otherwise contemplate since they prefer not to be involved in the origination and servicing of mortgage loans.

8.51 The major barrier to the short-term introduction of a secondary mortgage market in Tunisia is the lack of homogeneity of the existing mortgage instruments. Current lending terms vary considerably from one window to another. Although loan-to-value ratios appear low enough to satisfy risk-averse investors, they are actually higher, given that borrowers have little choice but to pool loans from several windows. Standardizing lending terms across windows, as proposed above, would contribute decisively to removing this drawback. The thinness of the secondary market is a major risk. It can be reduced to manageable proportions, however, if measures are taken to allow the transfer of mortgages or mortgage-based instruments from one ultimate investor to another. The easy transferability of assets is fundamental for the creation of a viable secondary mortgage market.

Chapter IX

FINANCING OF THE TREASURY AND PUBLIC ENTERPRISES

A. Financing of the Central Government Deficit

9.01 The financing requirements of the Central Government have grown markedly during the 1980s, from TD 98.9 million (2.8% of GDP) in 1980 to an estimated TD 473.3 million (7.6% of GDP) in 1984 (Table 9.1). Moreover, the structure of financing has been greatly altered. In 1980-82 external sources met 81% of the Government's requirements and domestic sources 19%, while for 1983-84 the external and domestic shares are estimated at 28% and 72%, respectively.

9.02 So far as domestic financing is concerned the Government has relied on a variety of sources, and its bank and nonbank borrowings have risen sharply. Net claims of the banking system on the Government, which on average rose only around TD 35 million a year over the period 1980-83, jumped by TD 97 million in 1984. This increase accounted for over half the monetary expansion that year. Nonbank sources, which contributed only TD 19 million in 1980, had a significantly higher share in 1983 and 1984.

9.03 Most of the bank financing takes the form of required subscriptions of capital equipment bonds (bons d'équipement) by deposit banks. In 1980-83 the increase in the value of such bonds held by banks represented 167% of net bank financing and 52% of total domestic financing. The Government has a current account at the Central Bank, movements in which are another key element of net bank financing.

9.04 Among other domestic sources of financing the major ones are deposits in postal checking accounts, deposits in the Caisse d'Epargne Nationale Tunisienne (CENT) and capital equipment bonds held by insurance companies, as well as deposits made available to the Treasury and capital equipment bonds held by CENT. Changes in the net obligations of social security agencies with the nonpublic sector also help to finance the consolidated Central Government deficit.

9.05 Overall, the main instrument of domestic financing is the capital equipment bond, representing 56% of the domestic funding used to finance the consolidated Central Government deficit in 1981-83.

9.06 Monetary financing of the consolidated State deficit has increased in recent years, and this has been a factor in the accelerated expansion of the money supply. It is therefore recommended that the Government reduce its use of bank financing not only to curtail the rapid increase in domestic liquidity, but also to avoid "crowding out" the credit needs of the nongovernmental sector (while adhering to the objectives recommended for expansion of the money supply and domestic credit). With this in mind, it is proposed that as originally envisaged in the Sixth Development Plan, the Government issue development bonds bearing interest rates that will ensure a

Table 9.1

TUNISIA -- FINANCING OF THE OVERALL CENTRAL GOVERNMENT DEFICIT, 1980-84
(millions of dinars)

	1980	1981	1982	1983 Provisional	1984 Budget
Total deficit (-)	-98.9	-105.5	-248.2	-303.2	-473.3
Financing	98.9	105.5	248.2	303.2	473.3
External (net)	80.4	108.7	176.0	74.9	146.4
Drawings	(...)	(167.2)	(267.0)	(193.6)	(306.0)
Repayments	(...)	(-58.5)	(-91.0)	(-118.7)	(-159.6)
Domestic (net)	18.5	-3.2	72.2	228.3	326.9
Banking system (net)	(-0.3)	(24.4)	(41.7)	(32.3)	(129.0)
Central Bank	-31.8	-16.4	2.3	-18.8	...
of which: Treasury current acct.	(-33.2)	(-16.0)	(-23.7)	(-5.7)	(...)
Deposit banks	31.5	40.8	39.4	51.1	...
of which: capital equipment bonds	(32.2)	(41.1)	(38.9)	(52.1)	(...)
Private sector	(10.4)	(25.5)	(24.9)	(12.6)	(-3.3)
Deposits	...	23.4	20.9	10.7	-9.0
CCP	(5.2)	(11.5)	(9.6)	(15.3)	(—)
CENT	(...)	(14.3)	(12.5)	(0.9)	(-19.5)
Other	(...)	(-2.4)	(-1.2)	(-5.5)	(10.5)
Borrowings	...	2.1	4.0	1.9	5.7
of which: capital equipment bonds	(...)	(2.9)	(4.7)	(2.6)	(5.8)
Insurance	...	4.6	5.9	4.9	7.1
Other	...	-2.7	-1.2	-2.3	-1.3
Public sector	(3.3)	(0.8)	(20.7)	(67.4)	(110.3)
Deposits	...	-1.9	17.1	49.6	70.8
Nonfinancial public enterprises	(...)	(-4.3)	(4.0)	(4.1)	(45.0)
Governmental admin. agencies	(...)	(0.2)	(5.8)	(16.8)	(10.0)
Public agencies & local govts.	(...)	(2.2)	(7.3)	(28.7)	(15.8)
Capital equipment bonds	...	2.7	3.6	17.8	39.5
CENT	(...)	(2.7)	(3.6)	(17.8)	(39.5)
Adjustments	...	(-29.7)	(-10.6)	(65.1)	(27.8)
Changes in obligations of soc. sec. ags. w/ nonpublic sectors	(5.1)	(-24.2)	(-4.5)	(50.9)	(63.1)
Percentages of financing					
External (net)	81.3	103.0	70.9	24.7	30.9
Internal (net)	18.7	-3.0	29.1	75.3	69.1
Banking system	(-0.3)	(23.1)	(16.8)	(10.7)	(27.3)
of which: capital equipment bonds	32.6	39.0	15.7	17.2	...
Private sector	(10.5)	(24.2)	(10.0)	(4.2)	(-0.7)
Public sector	(3.3)	(0.8)	(8.3)	(22.2)	(23.3)
Changes in obligations of soc. sec. ags.	(...)	(-23.1)	(-1.8)	(16.8)	(13.3)

Source: Central Bank of Tunisia, Financial Statistics (May 1984), and data reported by the Tunisian authorities.

reasonable return, intended for purchase by households and institutions. The domestic market may be narrow and the initial issues could be limited, which would make it possible to assess the market's absorptive capacity (see the section on the capital market). Besides helping to cut back the monetary financing of the Government budget deficit, this new instrument -- to the extent that it does not merely replace other types of financial holdings -- should help to tap additional savings.

9.07 It is important that the real cost of capital in Tunisia be reflected more accurately in all financial operations. Therefore, it is recommended that as part of a general modification of the interest rate structure, the Government gradually be required to pay positive real interest rates on all of its domestic borrowings.

B. Financing of Public Enterprises

Introduction

9.08 The main feature of the system of public enterprise financing in Tunisia is the multiplicity of financial roles played by the Government. As a promoter the State finances project studies and start-up costs. As a shareholder it takes up shares and makes capital grants, as well as receiving dividends. As banker, it raises funds within Tunisia by issuing capital equipment bonds, and obtains capital abroad for lending to the enterprises. Finally, as the State, it levies taxes, requires that money-losing or free services be provided, and grants compensating subsidies. This variety of financial functions was well justified in the early days of independence when a true Tunisian entrepreneurial class and sound financial institutions were lacking. After a quarter century this financial system can boast remarkable accomplishments despite its original character; one well worth noting among these is the emergence of a large number of management and operating teams showing great promise, and the beginnings of an entrepreneurial class that is beginning to become more powerful, even though both are still scattered among relatively closed family groups. This progress having been made, the original justification for the dominant role of the public enterprises has become less and less valid. Moreover, defects have begun to appear in the system of financing these enterprises. The purpose of this chapter is to present a brief analysis of the overall financial situation of the public enterprises, to look into their utilization of bank credit, and to discuss financial flows between the State and the public enterprises, ending with recommendations for improvement of the system.

Financial analysis of public enterprises 1/

9.09 There are about 300 public enterprises (PEs) in Tunisia, defining the term as any enterprise in which the State holds at least 10% of the capital stock, directly or indirectly. The value added of these PEs, aggregating over one fourth of GDP, is distributed as follows by sectors: about 60% in industry, 36% in services, and only 5% in agriculture and fishing. The public enterprises are of tremendous economic importance: they account for over half of all investment by enterprises (public and private) and over one third of

1/ However, this ratio is influenced by the fact that fixed assets have not been revalued for inflation, which means that equity capital is undervalued.

national investment; they employ over a tenth of the labor force, and nearly one fourth of all nonfarm wage earners; they pay nearly one third of total wages; finally, they account for over three fourths of exports and over half of imports. Nevertheless, given their role as government instruments for the implementation of certain social and economic policies, their financial situation has only recently begun to receive priority matching their economic significance. Attention is now also being focused on the complex management and efficiency problems arising from their pattern of production. The question of management is also made more difficult by the policy of controlled prices, which often fail to cover costs of production (see Plan Execution Report).

9.10 Table 9.2 presents some PE financial ratios for the sectors of agriculture, construction materials, chemicals and transportation for 1980-82. In most cases the liquidity ratio is less than one, indicating that realizable and available liquid assets fail to cover short-term debt. The situation is especially tight in the construction materials and chemicals sectors, where this ratio had fallen to about 0.50 in 1982. The ratio of permanent capital to fixed assets is slightly greater than one in most cases, but is sometimes lower, a sign that working capital is negative. Solvency, measured by the equity/debt ratio, seems to be decreasing in all of the sectors studied. 1/ The financial burden is particularly heavy in the chemicals sector, reaching 20% of value added in 1982. Consequently, the return on capital shown in the balance sheets and profit and loss accounts is generally negative. This finding would without question be significantly different in several cases if inflation-based accounting methods were used. But despite the financial situation the rate of investment has been quickening and the work force growing. Productivity of labor, as measured by the value added/work force ratio, fell sharply in the chemicals sectors 2/ and increased slightly elsewhere. The average wage has risen in all sectors, in general at a much faster annual rate than productivity.

9.11 The study on the profitability of the public enterprises, based on a sample of 50 enterprises in nine sectors, confirms these findings (Table 9.3). Including the oil companies in the sample, the overall rate of profit of the PEs (not adjusted for inflation) in relation to their turnover ranged from 1% to 4% in 1979-83. Excluding the oil companies the rate of profit was less than 1% in 1979 and 1980, and has been negative since 1981. On a sectoral basis, the PEs in the sectors of agricultural and food industries, textiles and paper and extractive industries have posted continuous losses for the last five years. Only the PEs in the electricity, water and tourism sector and the services sector showed profits in each year of that period.

1/ This section is based on the preliminary sectoral studies of public enterprises by the Ministry of Planning, and on more general surveys by the Ministry of Finance, drawing on a sample of 50 enterprises in nine sectors.

2/ Results in the chemicals sector can be largely explained by the slump on the world market for phosphate-based products, plus the low grade of Tunisian phosphate rock.

Table 9.2

TUNISIA: FINANCIAL INDICATORS OF PUBLIC ENTERPRISES

	Ratios							Rates of Change				
	Number of PEs in sample	Activity 1/	Liquidity 2/	Working capital 3/	Solvency 4/	Finan. burden 5/	Return on capital 6/	Value added	Invest-ment	Labor force	Product-ivity of labor 7/	Average Wage 8/
					(percentages)							
Agriculture	...											
1980		0.52	0.81	1.39	0.81	0.04	0.01	...	...	...	...	...
1981		0.52	1.06	1.48	0.78	0.04	0.06	23.9	5.4	4.2	18.9	17.1
1982		0.56	0.82	1.26	0.62	0.03	-0.04	3.3	-11.4	-8.0	12.3	23.0
Construction materials	15											
1980		0.50	0.67	1.03	0.65	0.04	-0.04	...	...	...	...	...
1981		0.59	0.68	1.08	0.61	0.04	-0.06	14.9	—	7.9	6.5	12.0
1982		0.67	0.48	1.03	0.51	0.05	-0.13	-18.5	51.8	-7.8	-11.2	23.7
Chemicals	9											
1980		1.14	0.68	1.19	0.45	0.13	0.06	...	...	...	...	...
1981		1.29	0.62	1.10	0.34	0.18	-0.04	-19.7	146.6	10.0	-25.0	3.1
1982		1.42	0.56	0.99	0.23	0.20	-0.20	-11.1	14.7	5.3	-17.9	10.0
Transportation	27											
1980		0.55	0.94	1.03	0.57	0.03	-0.04	...	...	...	...	...
1981		0.61	0.66	0.92	0.55	0.04	-0.06	18.8	36.3	7.3	9.9	13.3
1982		0.48	0.88	1.04	0.47	0.05	-0.11	11.1	65.6	—	12.5	23.9

Source: Ministry of Planning, March/April 1984.

1/ Turnover/permanent capital.
2/ Realizable plus available assets/short-term debt.
3/ Permanent capital/fixed assets.
4/ Equity/debt.
5/ Financial costs/value added.
6/ Operating income/equity capital.
7/ Value added/labor force.
8/ Personnel costs/labor force.

Table 9.3

TUNISIA: PROFITABILITY OF PUBLIC ENTERPRISES, 1979-83
(millions of dinars)

	1979	1980	1981	1982	1983
Including oil companies					
Income	1,106	1,347	1,607	1,783	2,107
Expenditure	1,073	1,286	1,564	1,762	2,093
Profit or loss 1/	33	61	43	21	15
(as percentage of income)	(3.0)	(4.5)	(2.7)	(1.2)	(0.7)
Excluding oil companies					
Income	1,019	1,207	1,423	1,538	1,821
Expenditure	1,013	1,204	1,440	1,590	1,878
Profit or loss	6	3	-17	-52	-57
(as percentage of income)	(0.6)	(0.2)	(-1.2)	(-3.3)	(-3.1)
Agricultural and food industries	-5	-13	-20	-9	-13
Services	4	5	5	9	5
Construction materials	4	5	4	-2	2
Transportation	3	-4	-16	-35	-28
Textiles and paper	-3	-2	—	-1	-1
Steel and chemicals	6	6	1	-4	-8
Extractive industries	-15	-7	-2	-22	-23
Electricity, water and tourism	12	13	11	12	8

1/ After allowances for depreciation and prior to taxes.

Sources: Ministry of Finance; Fund estimates. Data based on a sample of 50 enterprises.

Table 9.4

TUNISIA: INVESTMENTS AND SAVINGS CAPACITY OF PUBLIC ENTERPRISES, 1979-83
(in millions of dinars)

	1979	1980	1981	1982	1983 Proj.
Including oil companies					
Investments	...	...	461.8	608.2	669.5
Savings capacity	102.7	128.0	125.8	112.7	145.4
Profit or loss	(32.9)	(60.8)	(42.9)	(20.6)	(36.9)
Depreciation	(86.8)	(96.6)	(111.0)	(126.2)	(142.0)
Taxes on profits	(-17.0)	(-24.9)	(-28.1)	(34.1)	(-33.5)
Self-financing capacity (percent)	...	...	27.2	18.5	21.7
Excluding oil companies					
Investments	...	...	445.6	587.3	653.8
Savings capacity	78.0	80.8	78.3	53.5	79.7
Profit or loss	(5.9)	(2.8)	(-16.6)	(-52.9)	(-41.0)
Depreciation	(78.7)	(84.9)	(99.7)	(112.7)	(126.8)
Taxes on profits	(-6.6)	(-6.9)	(-4.8)	(-6.3)	(-6.1)
Self-financing capacity (percent)	...	...	17.6	9.1	12.2
Self-financing capacity (percent)					
Agricultural and food industries	...	...	-121.9	-23.5	-38.8
Services	...	...	81.0	162.2	82.8
Construction materials	...	...	176.4	6.7	136.2
Transportation	...	...	16.5	6.0	12.9
Textiles and paper	...	...	70.8	18.8	8.2
Steel and chemicals	...	...	27.6	13.3	46.6
Extractive industries	...	...	74.9	-20.9	-16.9
Petroleum products	...	...	291.4	283.3	418.5
Electricity, water and tourism	...	...	30.6	33.2	36.2

Sources: Ministry of Finance; Fund estimates. Data based on a sample of 50 enterprises.

Table 9.5

TUNISIA: BANK CREDIT TO PUBLIC ENTERPRISES, 1980-83

	1980	1981	1982	1983 (7/31/83)	Changes 1981	1982	1983
	(in millions of dinars)						
Credit to public enterprises							
1. Total amount	378.7	513.3	619.5	683.6	134.6	106.2	64.1
Short-term	(263.6)	(316.9)	(385.7)	(448.7)	(53.3)	(78.8)	53.0
Medium-term	(74.8)	(128.2)	152.2	(160.6)	(53.4)	(24.0)	(8.4)
Long-term	(40.3)	(68.2)	(91.6)	(74.3)	(27.9)	(3.4)	(2.7)
	(in percentages)						
2. Structure	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Short-term	69.6	61.7	63.9	65.6	39.6	74.2	82.7
Medium-term	19.8	25.0	24.6	23.5	39.7	22.6	13.1
Long-term	10.6	13.3	11.6	10.9	20.7	3.2	4.2
3. Percentage with respect to total credit							
Total	30.9	33.0	32.2	31.9	40.7	28.5	29.9
Short-term	(31.6)	(31.2)	(31.1)	(31.4)	(29.6)	(30.5)	(34.3)
Medium-term	(27.6)	(34.5)	(32.7)	(31.3)	(53.1)	(25.4)	(15.1)
Long-term	(34.2)	(40.8)	(38.4)	(38.9)	(56.6)	(17.5)	(60.0)

Source: Central Bank of Tunisia, Risk Analysis Unit.

Table 9.6

TUNISIA: BUDGETARY CONTRIBUTION TO PUBLIC ENTERPRISES, 1973-84

	1973-81	1981	1982	1983	1984 Proj.
		(in millions of dinars)			
Current transfers	285	13.1	31.5	35.0	145.0
Capital transfers	812	116.7	128.5	145.1	125.8
To financial institutions	(...)	(26.3)	(19.3)	(22.0)	(23.8)
To nonfinancial public enterprises	(...)	(95.4)	(109.2)	(123.1)	(102.0)
Net loans	(...)	37.4	42.5	48.6	83.0
To financial institutions	(...)	(-1.3)	(2.3)	(0.4)	(32.3)
To nonfinancial public enterprises	(...)	(38.7)	(40.2)	(48.2)	(50.7)
Equity participation	...	25.9	40.6	31.9	11.7
Financial institutions	(...)	(18.3)	(23.0)	(15.3)	(0.5)
Nonfinancial public enterprises	(...)	(7.6)	(17.6)	(16.6)	(1[illegible].2)
Budgetary contribution (BC)	1,097	193.1	243.1	260.6	365.5
Memorandum items					
GNP	...	4,171	4,898	5,520	6,203
Petroleum income	...	248.5	312.6	[illegible].7	309.3
External borrowings (net)	...	108.7	176.0	[illegible]4.9	146.4
Capital equipment bonds	...	47.0	47.2	72.5	...
Deposit banks	(...)	(41.4)	(38.9)	(52.1)	(...)
CENT	(...)	(2.7)	(3.6)	(17.8)	(39.5)
Private sector	(...)	(2.9)	(4.7)	(2.6)	(5.8)
Investments of nonfinancial PEs	2,421	461.8	608.2	669.5	726.5
		(in percentages)			
Ratios					
Budgetary contribution/GNP	...	4.6	5.0	5.3	5.9
Budgetary contribution/petroleum income	...	77.7	77.8	84.4	118.2
External borrowings (net)/BC	...	56.3	72.4	28.7	40.1
Capital equipment bonds/BC	...	24.3	19.4	27.8	...
Budgetary contribution/investments	45.3	41.8	40.0	38.9	50.3

Source: Data furnished by the Tunisian authorities.

9.12 Thus, the level of savings of the PEs is generally low (see Table 9.4). Excluding the oil companies the capacity for self-financing of investment ranged from 9% to 18% in 1981-83. The balance is financed in part by the banks, but primarily by the State.

Bank lending to public enterprises

9.13 The PEs absorb more than one-third of all bank credit, with an annual rate of increase of about 22% over the last four years (Table 9.5). The increase has been seen mainly in short-term credit, at the expense of medium- and long-term lending. As a percentage of investment, medium- and long-term loans fell from 24% in 1981 to 5% in 1982 and possibly an even lower percentage in 1983. This trend is explained partly by the urgent liquidity requirements of most of the enterprises and also by the activities of the new development banks.

9.14 The data on loans in judicial collection and doubtful loans are not yet available, a lack which is blamed on the governmental nature of the PEs. This attitude has undoubtedly enabled some PEs to finance their investments by means of bank overdrafts, thereby upsetting the financing scheme for those PEs and delaying corrective action. With the reform of the public enterprises it is expected that they will no longer enjoy implicit or explicit government guarantees, which will compel them to adopt stricter financial discipline. At the same time, the financial institutions will be expected to pay more attention in their risk analysis to the viability of the enterprises, their solvency and their loan repayments than to the guarantee extended by the State.

Financial flows between the State and the PEs

9.15 Since 1981 the PEs have been receiving an ever greater amount of government funding (see Table 9.6). Budgetary allocations have risen steadily from 4.5% of GNP in 1981 to 5.9% in 1984. This contribution has represented over three fourths of income from petroleum during the period, and in 1984 may even exceed that income. The mobilization of domestic financial resources by the Government through the mechanism of capital equipment bonds finances only one fourth of these budgetary allocations, and net borrowings one half.

9.16 The budgetary allocations are used primarily to subsidize the current operations of the enterprises. From about 10% on average in 1981-83, subsidies of this kind will probably rise to 40% by 1984 because the number of enterprises with difficulties increased and reorganizational and corrective measures were taken (see below). Capital equipment subsidies are substantial — averaging over 56% of the total budgetary allocation in 1981-83 — reflecting the very high rate of investment by the PEs. In addition, the Government takes part in constituting or increasing the capital stock of the enterprises (14% in 1981-83), and, acting as banker, it makes loans to them (20%).

9.17 Financial flows from the public enterprises to the State consist of loan repayments, direct and indirect taxes, and dividends. Aggregate data on these flows are not yet available. However, for the sample of 46 enterprises (excluding oil companies), net flows from the PEs to the State are negative (Table 9.7).

9.18 If budgetary transfers to the PEs can be maintained at such a high level it is due in part to petroleum income, which slightly exceeds the requirements of the PEs. Given the less favorable outlook for the petroleum sector in the medium term, budgetary assistance of this magnitude will no longer be possible.

Table 9.7

TUNISIA: FINANCIAL FLOWS BETWEEN PUBLIC ENTERPRISES AND THE STATE (1981-83)
(millions of dinars)

	1981	1982	1983
A. From PEs to the State			
Loan repayments	--	--	--
Direct and indirect taxes	93.50	106.40	...
of which: petroleum sector	(43.33)	(48.13)	(...)
Dividends			
of which: petroleum sector	(1.59)	(4.28)	(...)
Total:			
Including oil companies	95.22	110.80	...
Excluding oil companies	50.30	58.39	...
B. From the State to PEs			
Operating subsidies	4.22	5.26	5.47
of which: for reorganization	(—)	(0.10)	(0.37)
Financial and capital equipment subsidies	65.44	78.75	78.02
of which: for reorganization	(—)	(7.56)	(10.10)
Loans	8.74	13.32	7.86
Direct contributions and participations in capital	—	10.50	8.89
of which: for reorganization	—	(0.50)	—
Total:	78.39	107.83	100.24
of which: for reorganization	—	(8.16)	(10.47)
C. Net flows from PEs to the State			
Including oil companies	16.83	2.97	...
Excluding oil companies	-28.09	-99.44	...

Source: Ministry of Finance. Data based on a sample of 50 enterprises in nine sectors.

Reform of the public enterprises

9.19 A proposal for reform of the public enterprises was approved by the Council of Ministers on March 24, 1984. The implementation of the reform is to be based on several types of measures:

- reduction in budgetary allocations to the PEs;
- rehabilitation of some PEs;
- withdrawal of the State from enterprises in which its involvement is not essential.

These measures are analyzed in the paragraphs below.

Budgetary allocations to the public enterprises

9.20 The following measures are recommended, with the twofold objective of reducing budgetary allocations to the PEs and requiring greater discipline of them in the financial area:

(a) Establish overall productivity objectives through program contracts between the State and specific enterprises.

(b) Raise the prices of certain goods and services supplied by public enterprises, which have been kept too low as a result of strict price controls and anti-inflation measures introduced in 1981 and 1982.

(c) Fix subsidies calculated *a priori* to compensate enterprises that have to provide their services at unprofitable rates or prices or which are compelled to bear excessive costs for social or political reasons (labor costs in particular). Some of this financial compensation could be reduced through a new policy of consumer subsidies, selectively targeting low-income groups, and a more general policy on employment (interest rate policy, wage policy, choice of investments, etc.).

(d) The financing of capital equipment by the Treasury for public enterprises (capital equipment contributions and subsidies, loans) should be replaced (except in the case of public utilities run as public enterprises) with loans obtained directly by the enterprises from commercial banks, development banks and suppliers, or — in the medium term — by securities issued on the financial market. The basic purpose of this reform is to allow a transfer of responsibility from the Treasury, which has acted as a banker up to the present, to the financial institutions and enterprise managers. The following benefits may be expected from a shift of this kind: (i) much more rigorous evaluation of projects; (ii) closer monitoring by the financial institutions; (iii) price of credit that reflects the cost of resources; (iv) more accurate calculation of production costs, leading to remunerative selling prices.

Rehabilitation of PEs

9.21 The list of enterprises to be given priority for rehabilitation has been finalized (see Table 9.8) and the deadline for preparation of the rehabilitation and reorganization programs for these enterprises has been set at the end of October 1984. The problem enterprises are found particularly in the following sectors: mining (SOTEMI, CPG), reflecting mainly the social objective of maintaining regional employment; textiles (SOGITEX, SOMOTEX) and tourism (SHTT, Tour Afrique), whose role in promoting private enterprise has been fulfilled; and chemicals (CPG, ICM, SAEPA), which has been the sector most affected by the world recession and the deterioration in the terms of trade. A number of financial factors also have contributed to the need for rehabilitation: inadequate investment financing arrangements; insufficient initial capital (SMMT, CAT); financing of long-term projects by very short-term bank overdrafts (SHTT); overstaffing and obsolescence of equipment (SMMT); poor accounting practices and the absence of cost accounting that would make it possible to pinpoint the source of financial imbalances.

9.22 The government budget for 1984 includes an appropriation of TD 145 million to finance corrective measures, excluding capital losses, forgiveness of tax debts or their conversion to capital, and forgiveness of government loans or their conversion to capital. This appropriation includes, in particular, compensation for the losses incurred as a result of the devaluation of the dinar in respect of foreign borrowings denominated in dollars. In addition, the Government is counting on the financial institutions for support in its rehabilitation effort. The commercial banks could convert some bank overdrafts to long term debt, or some long-term loans to shares. Their resources are limited, however, and expansion of their facilities could be inflationary. In order to safeguard their own viability, the development banks surely will insist on a revaluation of the assets of these enterprises more or less in their favor, with some safety margin. They will also seek to obtain from the Government the transfer and operating conditions necessary for the long-term financial profitability of these enterprises.

State withdrawal

9.23 The Government is in the process of deciding which PEs are to remain subject to direct State control and those whose control should be transferred to parent companies (sectoral holding companies, commercial banks, development banks). The following comments are worth considering:

(a) The ultimate objective should be government financial withdrawal from all public enterprises that compete with other firms. After this withdrawal, the public enterprise sector would continue to play an important role, since all enterprises providing public services and representing natural monopolies would remain in the sector. Even in the case of enterprises in the competitive sector, their transfer to the development banks or the private sector will of necessity be gradual. The transfer of enterprises in difficulties should not be considered without action first being taken to correct some of the root causes of such difficulties (for example, employee redundancy due to a decline in the demand for goods or services produced). Moreover, the size of the development banks' available resources and the smallness of the capital market severely restrict the amounts of transfers of those public enterprises that could be "privatized" relatively quickly, so that progress will of necessity be gradual.

(b) Each transfer should be total and definitive. It would be done better through the sale of equity holdings than through the transfer of supervisory authority. This approach would ensure the independence of the purchasing entities and would open up possibilities for some transfers to the private sector in the future.

(c) In an initial phase the transfers should be made chiefly to development banks, as planned by the Tunisian authorities. Owing to the virtual nonexistence of a capital market and considering the amount of financing required, the development banks are practically the only institutions that can assist the Government in the gradual transfer of viable public enterprises to the private sector. The commercial banks have only limited potential for increasing their equity portfolios, given the nature of their resources. The development banks are best equipped to make the transfer; their role would be to make the public enterprises transferred profitable.

Table 9.8

TUNISIA: PUBLIC ENTERPRISES FOR PRIORITY FOR REHABILITATION

	Enterprise	Products	Government share	Capital stock 1982	Turnover 1981	Turnover 1982	Turnover 1983	Profit (- loss) 1981	Profit (- loss) 1982	Profit (- loss) 1983	Investment 1981-83
			(in %)	(In millions of dinars)							
Group I	SOGITEX	Textiles (Holding)	99.2	6.18	2.37	0.87	0.80	-0.57	-0.02	-0.02	—
	SOMOTEX	Textiles (Monastir)	100.0	5.20	10.60	11.44	12.65	1.04	-1.[illegible]7	-0.80	2.85
	SNCPA	Cellulose and paper	100.0	6.08	17.39	19.82	22.32	-0.93	-1.17	-1.11	2.36
	SNL	Cork	94.5	0.55	1.58	1.57	1.38	—	—	-0.13	0.88
Group II	SOTEMI	Mining	100.0	2.61	2.85	3.15	2.93	-3.37	-3.71	-5.05	1.62
	STS	Sugar	84.0	3.40	13.71	9.61	14.76	-1.22	-1.22	-1.51	1.09
	STIL	Dairy products	77.8	2.60	57.11	17.50	18.70	0.17	1.96	0.78	4.01
	ACMG	Mechanical construction	92.5	2.50	3.75	3.90	6.96	-1.80	-2.29	-1.73	2.83
Group III	CAT	Artificial cement	92.7	2.10	20.88	16.87	27.89	-0.51	-2.86	-1.14	5.34
	CIOK	Cement	100.0	28.00	14.60	14.23	22.79	-3.55	-5.18	6.79	5.65
	Confort	Refrigerators	98.3	1.85	17.04	12.53	17.65	-0.52	-0.96	0.12	1.07
	COGELEL	Electrical	90.2	0.13	1.87	2.07	...	-0.54	-0.23	...	...
Group IV	ICM	Chemicals (Magreb)	48.7	20.00	49.17	58.15	88.99	-0.14	-2.94	-6.91	34.74
	SAEPA	Fertilizers	60.0	33.43	72.66	78.51	84.23	-5.84	-9.77	-7.92	47.76
	SMMT	Mining and metallurgy	100.0	0.66	8.16	6.08	6.14	-2.54	-2.22	-2.25	1.80
	SOTIMACO	Construction materials	97.6	2.81	5.16	5.61	7.20	0.04	0.07	0.06	0.31
Group V	CPC	Phosphates	99.6	39.00	81.79	88.09	105.5	1.32	-19.89	-22.11	68.97
Group VI	SHTT	Tourist hotels	92.6	5.00	10.79	10.90	10.77	0.05	-0.91	-1.40	15.28
	ONA	Crafts	100.0	3.00	6.02	6.31	7.78	-0.80	-0.95	-1.60	0.69
	TOURAFRIC	Tourism	...	0.32	1.44	...	...	-0.15	...	...	...

Source: Ministry of Finance.

(d) In the medium and long term there would be economic advantages in "privatizing," at least in part, some of the public enterprises transferred to the development banks. Transfer to private ownership (i) would preclude any bottlenecks that might appear because of insufficiency of the development banks' resources; (ii) could help to improve the return on capital; and (iii) would be a key factor in stimulating the activity of the capital market (see paragraph 10.26). Schemes could be devised now to interest employees in profit-sharing in their enterprises, primarily through the purchase of shares on preferential conditions.

9.24 The transfer of public enterprises from the State to the development banks will ordinarily have to be preceded or supported by reorganization programs aimed at improving management and operation, and in many cases this will necessitate additional investments or staffing cutbacks (which will give rise to difficult social problems and require arrangements to compensate laid-off workers and retrain them for other jobs. In deciding upon the conditions for transfer the development banks should assess the reorganization programs to ensure that investments are clearly in accordance with the criteria set forth in their General Policy Statements 1/. Transfer of the public enterprises will be successful only as part of a general liberalization of economic policy, particularly as concerns prices (see the Plan Execution Report).

9.25 Eligibility for financing by the development banks should be limited to public enterprises that can become financially profitable and technically viable, and can be managed on a commercial basis (without subsidies from or direct control by the State). If the Government finds that these criteria cannot be met by certain enterprises (for political, social or other reasons), it would be preferable to keep them under its control, and in some cases to finance them in part from the budget. However, it may be necessary in the long run to liquidate some of the enterprises to avoid the heavy budgetary expenditures they entail.

9.26 The development banks can also become involved in public enterprises that are not transferred, assisting with reorganization, rehabilitation, modernization or reorientation -- provided that the purpose of such involvement is to meet the criteria mentioned in the foregoing paragraph.

9.27 It is still too early to estimate the amounts required by the development banks to finance the transfer of the public enterprises in the years ahead. Given the magnitude of the State's role (over TD 500 million of investment in manufacturing industry alone in 1980-83), these sums could be large. Nonetheless, the withdrawal will have to be gradual and the role of the Government will remain significant as least in the near future.

9.28 The withdrawal of the State from responsibility for financing public enterprises should be accompanied by a transfer to the development banks of some of the financial resources that the Treasury is now raising through capital equipment bond issues and using to fund those enterprises.

1/ One example of a successful rehabilitation effort currently under way is the SOGITEX textile holding company.

Chapter X

THE CAPITAL MARKET

A. Overview

10.01 The capital market in Tunisia is not very well developed. There is little diversification of the securities traded, which are limited to shares and to ten-year bonds issued or guaranteed by the State. The volume of trading on the secondary market is small.

10.02 The State and institutional investors dominate the market, with scant participation by the general public. The bonds issued or guaranteed by the Government are heavily subscribed by banks, insurance companies, the Caisse d'Epargne Nationale Tunisienne (CENT) and the social security agencies. The banks are the leading participants in the securities market. Brokerage activities are virtually the sole province of banks and their affiliates. Furthermore, of the 44 companies listed on the Stock Exchange, nine are banks whose shares account for the vast majority of total transactions. Finally, the Government is a shareholder in 39 of the 44 listed companies, holding a majority in 26 of them.

10.03 The securities traded on the capital market are divided among three categories: (1) instruments issued by the State, consisting of ten-year capital equipment bonds (bons d'équipment); (2) compulsory borrowings guaranteed by the State, consisting basically of ten-year borrowings of the Banque de Développement Economique de Tunisie (BDET) and, more recently, of STUSID; and (3) shares issued by companies. As Table 10.1 shows, during the last five years issues of capital equipment bonds grew steadily and continuously except in 1981. Conversely, share issues have undergone sharp fluctuations, especially since 1981 when the volume traded was nearly six times greater than in the previous year. In the last five years share issues have increased at a much faster rate than bond issues: shares accounted for 59% of total issues on the capital market in 1983, against 34% in 1979. The volume of compulsory borrowings was negligible throughout the period considered.

Table 10.1

GROSS ISSUES OF BONDS AND SHARES
(in TD 000)

	1979	1980	1981	1982	1983
Capital equipment bonds	100,946	110,903	154,323	150,903	177,962
Compulsory borrowings	1,000	-	2,300	2,115	2,186
Shares	52,286	53,392	314,198	155,685	259,081
Total	154,232	164,295	470,821	308,703	439,229

Source: Stock Exchange, 1983 Report.

B. Structure

The Primary Market for Fixed-Yield Securities

10.04 Capital equipment bonds: Gross issues of capital equipment bonds increased by 17.7% in 1983 compared to a fall of 2.2% in 1982. These bonds, which have accounted for over 20% of the capital equipment budget for the last few years, are ten-year bonds bearing interest of 5.5% which is exempt from the securities income tax (IRVM). The interest rate has remained unchanged for more than ten years, despite the fact that interest rates in general have risen significantly during that period.

10.05 All subscribers to capital equipment bonds are institutions: banks, social security agencies, and insurance companies. In 1983 gross subscriptions to these bonds by social security agencies totaled TD 44.5 million, those by insurance companies 10.8 million, and that by CENT TD 23 million. The remainder of gross subscriptions (over 50%) was financed by banks.

10.06 Banks and insurance companies are obliged to place part of their funds in capital equipment bonds. As indicated in Chapter V, banks are required by the Central Bank of Tunisia (BCT) to place 20% of their total demand and time deposits and special accounts in capital equipment bonds. In fact, the 20% proportion of capital equipment bonds was in general slightly exceeded in 1983 and 1984, reaching between 21.4% and 20.2% between December 1983 and October 1984. Banks are also obliged to set aside 5% of their deposits for CNEL bonds; as noted in Chapter VIII, however, they are falling far short of that proportion in the absence of new issues by CNEL, which has enjoyed a large liquidity surplus for a number of years.

10.07 Insurance companies, pursuant to the Ministry of Finance Order of August 21, 1979, are obliged to place at least 50% of their technical reserves in capital equipment bonds. The actual proportion was only 42.4% in 1982 (the latest year for which figures are available) compared to 41.8% in 1981. The difference is due basically to a large accumultation of insurance premiums owed by public enterprises.

10.08 There are, then, no voluntary subscriptions by the Tunisian private sector to capital equipment bonds. The reason is that the yield on these bonds is decidedly less than that on other financial instruments such as time accounts, special savings accounts, and compulsory BDET borrowings. Moreover, since the borrowings in the form of "Bonds" of 1955, 1964 and 1967, the State has issued no further borrowings intended for the general public.

10.09 Bond Borrowings: BDET was the sole issuer of bond borrowings from 1982 until recently, when it was joined in that function by STUSID. In contrast to capital equipment bonds, interest rates on BDET bonds have risen steadily since 1980, causing a very rapid growth of total subscriptions, but particularly those by companies and private investors (see Table 10.2). In fact, subscriptions by companies and private investors rose from 34% of total subscriptions in 1975 to 65% in 1983. STUSID has issued two zero-coupon borrowings: one at 10 years, with an issue price equal to 40% of the repayment price (thus at an implicit interest rate of 9.6%); and one at 5 years, with an issue price equal to 70% of the repayment price (implicit interest rate 2.4%).

10.10 Among institutions, only insurance companies invest part of their resources in Government-guaranteed instruments, such as BDET borrowings, pursuant to the legislation in force. Subscriptions to bonds can range from 0% to 50% of the technical reserves of insurance companies. This explains the very low volume of voluntary subscriptions by other institutions. The banks prefer more profitable placements, primarily because BDET borrowings are not calculated as part of the proportion mentioned in paragraph 10.06; and the social security agencies -- some of which, like the Caisse Nationale de Retraite, are short of liquid funds -- apparently give priority to capital equipment bonds.

Table 10.2
ISSUES OF COMPULSORY BDET BORROWINGS
(in TD 000)

Year	Subscriptions					
	Insurance companies	Social security agencies	Banks	Other companies	Private investors	Total
1973	225.00	150.00	100.00	479.50	45.50	1000.00
1974	305.00	150.00	150.00	356.04	38.96	1000.00
1975	934.04	250.00	461.44	641.10	213.42	2500.00
1980	735.00	700.00	210.00	430.36	156.54	2231.39
1982	570.00	--	--	1348.00	197.39	2115.39
1983	656.00	--	100.00	1196.04	234.40	2186.44

Source: BDET, Securities Department.

10.11 Since 1980 BDET borrowings have been issued in two categories, exempt and nonexempt. The exemption applies to subscriptions up to a maximum of 30% of taxable income for individuals and 50% of taxable income for corporate bodies. In 1983 the nonexempt type carried interest of 10.25% and the exempt category 7.75%. The exempt category represented 89% of the total. However, interest paid on the non-exempted category is included in the assessment for the State personal tax (contribution personnelle d'Etat - CPE) for individuals and the business tax (patente) for corporate bodies, which is not the case for capital equipment bonds carrying tax-deductible interest. If a corporate body with an income of TD 100,000 places 30% of its income in capital equipment bonds, it obtains a net-of-tax rate of 5.5%. If it places the same proportion of income in exempt BDET borrowings, the net yield will be 7.75%; and if it selects nonexempt BDET borrowings (at 10.25%), net after-tax yield will be only 4.5%. In these circumstances, the net after-tax yield of the 1983 BDET borrowing generally remains higher than that of the capital equipment bonds, if the exempt category is selected, but in the case of the nonexempt category it will be lower. The recent increases in bank deposit interest rates (see Chapter II) will involve corresponding increases in the level of future issues of compulsory borrowing.

The Secondary Market for Fixed-Yield Securities

10.12 The secondary market for fixed-yield securities is extremely narrow. The transactions volume was TD 63,000 in 1983 and 232,000 in 1982, i.e. less than 1% of the total volume for each of the two years. Because subscribers to capital equipment bonds are nearly all government agencies and financial institutions which are legally obliged to maintain minimum portfolios of these bonds, they do not tend to trade them on the secondary market. The very low volume of trading in BDET borrowings is explained mainly by the fact that the original subscriber is eligible for the tax exemption only if he holds the bonds for at least five years, or reinvests the proceeds of sale in other tax-exempt instruments.

The Primary Market for Variable-Yield Securities

10.13 The value of new shares issued in 1983 was TD 259 million against TD 156 million in 1982, an increase of 66%. Table 10.3 indicates that the majority of these share issues are due to the establishment of new companies. In 1983, 176 corporations were established compared to 177 in 1982, but the average size of new companies has grown as well. Furthermore, capitalization by capital increases in 1983 totaled a record TD 113 million, almost three times greater than in the previous year. Some 67% of that amount represented capital increases by ten companies. It should be noted that a number of companies are continuing to issue shares with a very high par value (as much as TD 1,000), which hardly contributes to participation by the public in the primary market. In fact, there have been no share issues intended for the general public for the last several years. This market is dominated overwhelmingly by institutional investors.

Table 10.3
NEW SHARE ISSUES
(in TD 000)

	1979	1980	1981	1982	1983
Establishment of corporations	14,892	30,594	259,205	117,561	145,695
Capital increases	37,394	22,798	54,992	38,125	112,886
Total	52,286	53,392	314,197	155,686	259,081

Source: Stock Exchange, 1983 Report.

10.14 The banks and the tourism sector have been the primary beneficiaries of new share issues, the former accounting for 49% and the latter 16%. They are followed by chemicals (12%) and construction and public works (5%).

The Secondary Market for Variable-Yield Securities

10.15 The volume of transactions in variable-yield securities 1/ has grown steadily though slowly since the Stock Exchange was established in 1971. Total volume traded was TD 23.8 million in 1983, against TD 23.1 million in 1982. However, the share of the permanent market rose from 23% to 26% during the same period.

Table 10.4
TRANSACTIONS IN VARIABLE-YIELD SECURITIES
(in TD 000)

	1979	1980	1981	1982	1983
Permanent market	3,869	3,118	5,892	5,386	6,222
Occasional market	8,194	17,690	13,894	17,719	17,533
Total	12,063	20,808	19,786	23,107	23,755

Source: Stock Exchange, 1983 Report.

10.16 The permanent market is the official market. There are 44 companies traded, together with State borrowings and capital equipment bonds and some compulsory borrowings. Prices on this market may not fluctuate more than 5% upward or downward at any session. Companies listed on the permanent market are also required to file annual financial statements with the Exchange. By law, all securities transactions must take place at the Exchange or be approved there. Unapproved direct transfers are therefore illegal. The occasional market is the one that handles all transactions of securities that are not permanently listed. Prices on this market may move freely without being bound by the 5% upward or downward limit. Finally, unlisted companies are not legally required to file annual financial statements with the Exchange.

10.17 Despite the record volume of TD 6.2 million posted in 1983, trading on the permanent market remains very limited. Only 44 companies are listed and turnover is low. There were 866 transactions in 1983, with an average of TD 7,185 per transaction. Only three securities had a turnover rate of over 10%. Furthermore, the market is heavily dominated by the banking sector, with 80% of the volume traded in 1983 (compared to 74% in 1982); far behind was the construction and public works sector with 10.5%. According to Stock Exchange officials, the average gross yield on the permanent market decreased from 7.9% in 1982 to 7.7% in 1983. This was due in part to the fact that commercial bank dividends have been at most 6% to 8% in recent years, because of the reserve requirements imposed by the Central Bank. Share yields on the permanent market are substantially lower than those of other financial instruments available in Tunisia, such as BDET bonds and the time accounts and certificates of deposit offered by banks (see paragraph 10.11). In calculating net yield one must subtract brokerage fees of as much as 1.6% per transaction, as well as the securities income tax (IRVM) on dividends withheld at the source at the rate of 30%.

10.18 Trading volume on the occasional market fluctuates widely from one year to the next. The main reason is that the market is usually dominated by a small number of transactions in very large amounts. These operations involve transfers of large blocks of shares among majority shareholders. They

1/ In addition to shares, variable-yield securities included assignment and subscription rights. The volume of rights traded has always been negligible.

attest to the high degree of concentration of ownership and to the desire of the principal shareholders to retain control of their firms. For example, in 1982 five transactions of this kind accounted for 35% of the total volume traded on the occasional market.

10.19 From a sectoral standpoint the occasional market is much more diversified than the permanent market. The sectoral distribution of turnover varies greatly from one year to the next, but is seldom dominated by the same sectors. The ones that are usually best represented are agroindustry, tourism, construction and public works, mechanical and electrical industries, and chemicals.

Brokerage Agents

10.20 Stock exchange intermediation in Tunisia is dominated by the banks. Of the 16 brokerage agents operating in the stock market, there are ten commercial banks, four development banks, and two portfolio management companies which are subsidiaries of commercial banks. The law permits individuals to operate as brokers, but the volume traded on the Exchange is so small that it would be difficult for a private broker to earn an adequate income. During the last five years the distribution of stock exchange transactions by agent has been nearly equal: the most active broker has accounted for less than 20% of total turnover. It should also be pointed out that most stock trading is done by brokers for the account of their own financial institutions. Only two banks carry out a comparatively large number of transactions for the account of their customers. In addition, the vast majority of operations are handled by the same broker for both purchase and sale.

10.21 In summary, the secondary market for fixed-yield securities is not well developed. It suffers from a chronic lack of liquidity, reflected in a very low turnover rate. The permanent market is heavily dominated by the banking sector and offers a limited number of options.

C. Development of the Capital Market

Introduction

10.22 The primary objective of the development of the capital market should be to increase the volume and diversification of the medium- and long-term financial resources available for Tunisia's economic development. Diversification of the range of financial instruments offered to savers would be likely to have a favorable impact on the mobilization of private financial savings.

10.23 Enabling Tunisian firms to tap financial savings directly would be beneficial both to the firms themselves and to the financial system in general. In a developed market firms can more readily raise funds from the general public for capital increases. This would ameliorate the financial situation of many companies by allowing them to improve their equity/debt ratio. Direct access by firms to the primary market through the issuance of shares or bonds would lessen their dependence on banks, and therefore would foster greater competition within the financial system. The result would be improved effectiveness of financial intermediation in the allocation of resources.

10.24 Development of the capital market also will help to fulfill two major objectives: (1) to make share ownership in Tunisia more democratic, and (2) to increase the inflow of Arab and foreign capital. Shareholding in Tunisia is heavily concentrated in the Government and financial institutions. Development of the market will make it more liquid and will afford small investors greater protection. Investment in securities will therefore be less risky. Furthermore, the saver will be able to divest himself of these securities more readily if he needs cash. At present the Tunisian Government grants many advantages to Arab and other foreign investors, but a diversified and liquid financial market would be one more fundamental guarantee for foreign investors.

Potential for Development of the Market

10.25 The potential for developing the capital market in Tunisia is considerable. Such development could be based on an extensive supply of shares and bonds from the development banks and the Government. As a matter of fact, the Government would like to enable the private sector to participate in the financing and in the prosperity of certain public enterprises, while the development banks need to turn over their share portfolios and issue bonds to finance expanded operations.

10.26 Private sector and public enterprises: The Government has decided to gradually promote greater private-sector participation in the development of some of the public enterprises. As noted in Chapter IX, there are 300 enterprises with public sector participation, the State being a direct shareholder in about 100. The Government holds shares in 39 of the 44 companies permanently listed on the Stock Exchange, and is the majority shareholder in 26 of them. The share portfolio of the State is estimated at about TD 300 million. Privatization of some State holdings would expand the supply of shares on the market to a significant extent. Even if the authorities should not wish to lose their direct control over public enterprise management, it would be possible to sell part of the shares of those enterprises on the stock exchange, while maintaining the public sector's majority capital holding. Direct purchase of a large part of these shares by private savers would help both to solve the problem of financing the transfer of certain public enterprises and to develop the capital market.

10.27 Turnover of the share portfolio of development banks: The share portfolio of the development banks has grown sharply over the last three years, from TD 34 million at the end of 1980 to almost TD 100 million at the end of 1983. This rapid growth has been due chiefly to the establishment of four heavily capitalized Arab-Tunisian development banks (TD 100 million for BTKD and STUSID, and TD 50 million for BTQI and BTEI). They have undertaken an ambitious program of financing new projects, and a large share portfolio has resulted; it is likely to continue its rapid growth in the years ahead. However, the Arab-Tunisian development banks will soon have invested nearly all of their capital in medium- and long-term placements, and are actively seeking other resources on the domestic and foreign markets. It would be beneficial for them to be able to turn over their share portfolios for their own refinancing, and to realize the appreciation which is essential to their profitability.

10.28 Issuance of bonds by the development banks: The Arab-Tunisian development banks intend to satisfy part of their resource requirements by issuing compulsory borrowings on the local market at competitive rates, comparable to those paid on BDET bonds. STUSID has already issued a loan of this type, as mentioned in para. 10.9. BDET also intends to continue its bond issues, especially after the success of the 1983 issue.

10.29 All of the foregoing indicates that over the next few years the capital market will probably be faced with a significant increase in the supply of shares and bonds. The fundamental and urgent problem is on the demand side: how and by whom will these new financial instruments be taken up? The absorptive capacity of the commercial banks is quite limited, particularly since their resources are essentially short-term, which prevents them from holding a substantial securities portfolio. Foreign and particularly Arab capital could absorb some of the planned issues, but recourse to Tunisian private savings is inevitable. The development of an efficient stock market which guarantees a minimum of liquidity, and where the interests of small investors are protected, is a sure method for expanding financial savings and channeling them to the capital market.

Suggestions for Development of the Capital Market

10.30 The measures suggested below to develop the capital market can be grouped in four categories: (a) expansion of the supply of shares and bonds available on the market; (b) tax measures; (c) institutional improvements to stimulate the secondary market; and (d) better protection for investors. Most of the measures in the last three of these categories are needed to stimulate the demand from private savers for securities.

Expansion of the Supply of New Securities on the Market

10.31 At present the market is suffering from a shortage of new fixed- or variable-yield securities for public subscription. The foregoing paragraphs indicate that there is a significant potential supply of short- and medium-term instruments. The measures needed to actualize this potential should be taken. Furthermore, the necessary steps should be taken to ensure that the securities issued are competitive and attractive enough to tap household savings directly.

10.32 Despite the fact that in certain cases shares not listed on the stock exchange are traded more briskly than some listed shares, it is essential to try to overcome the present acute shortage of shares listed on the permanent market. With this goal in mind, the Government could become more active in offering for permanent stock-exchange listing shares of certain companies that it controls. Such shares of those companies could be sold on the stock exchange to the general public, even if the Government were interested in retaining a majority capital holding. The financial institutions should be brought into these operations to regularize the market and avoid a sharp downswing in prices. Purchases by the development banks should be temporary and financed out of their own resources. At the same time, some of the shares could be purchased initially by variable-capital investment companies (SICAVs), then sold directly to savers in a second round, either by the SICAVs or by the State.

10.33 The principle of raising private funds has already been adopted. Its implementation should improve the Government's budgetary situation. The following needed precautions must, however, be stressed: (1) only shares of companies with a high rate of return should be offered to the public, which means that government companies now losing money should be rehabilitated before the offering of their shares on the Stock Exchange can be considered; (2) the sale on the market of shares now held by the public sector should be very gradual, so as not to cause a slump in prices, and to ensure a continuous supply of attractive securities.

10.34 In light of the favorable reception of the recent issues by BDET and STUSID, the development banks should continue to issue bonds that tap private savings directly. The offer of new types of bonds with attractive yields would result in expanding the market for new subscriptions, as already demonstrated with the STUSID issue. Initially, five-year rather than ten-year bonds would be issued, making them less risky in the eyes of investors. They would bear an after-tax interest rate equal to that paid on two-year deposits, with a premium of at least 1%.

10.35 Because of the rigid and controlled structure of interest rates in the capital market, an abrupt rise in rates shortly after a major public bond issue would have a disturbing impact because it would cause capital losses to savers and would shake their confidence in the new market. The success of these new issues will depend in large measure on the time selected to launch them, which should not precede a rise in interest rates.

10.36 To forestall the risk of capital losses to savers due to future increases in interest rates, it would also be worthwhile to consider the issuance of bonds at variable interest rates. In order to avoid disrupting the operation of the financial system, these interest rates should be tied to the rate on time deposits. For instance, the interest rate on a bond issue could be adjusted annually to equalize it with the interest paid on two-year deposits at the time of the adjustment, plus a spread of, say, 1%. With this type of bond (a) fluctuations in the overall level of interest rates would be reflected in the rates paid on bonds, and the price at which they are quoted on the market would always remain very close to their nominal value; (b) consequently, savers would face no risk of capital loss; (c) the cost of resources to borrowers would follow the cost of bank credit very closely; (d) with the decrease in risks to savers and borrowers, the term of borrowings could be quite long (for example, seven years or even more).

10.37 The development of the bond market should also enable nonfinancial public enterprises and private companies to tap local savings directly by issuing bonds. This would have the effect of lowering their borrowing costs since they could partially circumvent bank intermediation. Given the present stage of development of the capital market in Tunisia it would be hard for a public issue of bonds without government guarantee to be floated successfully. Actually, the general public and institutional investors are not accustomed to this type of issue; there is no financial institution — such as an investment bank — that could underwrite the bonds, while the secondary market is still embryonic. For this reason, it seems necessary for the initiative in the issuance of bonds to come first from the development banks even though an issue by a first-class public or private enterprise could take place soon after.

Tax Measures

10.38 Tax measures aimed at developing the securities market are of two types: (i) those intended to encourage savers to invest their funds in securities; and (ii) those intended to increase the supply of securities by encouraging companies to offer their securities to the public and to be listed on the permanent market, overcoming the reluctance of owners to disclose information about their companies to outside parties.

10.39 The Government has already adopted major tax-incentive measures in the first of the areas mentioned. Any financial investment in securities entitles the investor to a partial tax exemption on his taxable gain. The exemption can be as much as 50% of the taxable profit for corporate bodies and 30% of annual income subject to the CPE for individuals. To be eligible for these exemptions, however, investors must hold the securities for at least five years or must reinvest the proceeds of their sale in approved securities. This limitation lessens the liquidity of a securities portfolio because it penalizes an investor who must sell off part of his holdings. In general, it reduces the flexibility that would enable the investor to profit from a change in the market situation. For these reasons, it would be desirable to make the system more flexible, for example by providing that after an initial 3-year period the securities benefiting from the exemption may be sold with only partial loss of the tax advantages granted.

10.40 Dividends on shares are subject to the IRVM, which is withheld at the source at a rate of 30%. The 1983 Finance Law established a tax credit such that the IRVM withheld at the source is taken as a credit toward the individual CPE; until 1983 the IRVM was not recoverable. However, dividends are still at a disadvantage vis-a-vis interest paid on bank deposits, and particularly on special savings accounts. This is due to the IRVM with 30% withholding at the source, whereas there is no such withholding on special savings accounts, and assessments and taxes on interest from other types of deposits are less than 30%. It is therefore essential, for the sake of more balanced competition between shares and bank deposits, to lower the IRVM rate on dividends to that of the income tax on time deposits, and to provide for withholding of the latter tax at the source. The tax exemption for special savings accounts could be retained, since there is an upper limit on these taxes, but the amassing of several savings accounts by a single depositor should be monitored more closely. This measure would make a significant contribution to the development of the securities market.

10.41 The development of that market could also be fostered through tax advantages for companies listed permanently. However, the audit of the accounts of listed companies should be stricter than it is at present. If a more thorough audit of the accounts of listed companies becomes feasible, it will be necessary to stimulate those companies' interest in keeping their shares permanently listed, applying a profits tax rate lower than that applied to nonlisted companies. For example, it might be possible to effect a slight increase (e.g. 1%) in the tax rate on profits of companies that are eligible for listing on the exchange but not listed, and to lower (e.g. by 4%) of the tax rate on profits of listed companies. In addition, the tax on stock exchange transactions (TTB) should be lowered from 0.8% to 0.4% for transactions on the official market (permanent listing).

Institutional Changes

10.42 Tunisian law provides for the formation of variable-capital investment companies (SICAVs), but such companies do not yet exist in Tunisia. SICAVs, which pool the savings of private individuals and entrust their management to professionals, could perform a key function in channeling private savings to the capital market. The State should grant advantages to SICAVs and eliminate double taxation. A public information campaign could also be undertaken to explain the concept of SICAVs and call attention to the advantages they can offer.

10.43 Insurance companies could play a major role in the capital market. However, their activities in that market over the years have been minimal and passive, owing to three main factors: (1) the thinness of the secondary market; (2) the legal limitations imposed on the utilization of technical reserves; and (3) the tight financial situation of the insurance sector.

10.44 The reasons for the narrowness of the secondary market have been discussed above. The insurance companies are not very active on the stock market, limiting their involvement to the primary market. It was noted in paragraph 10.07 that pursuant to the Ministry of Finance Order of August 21, 1979, insurance companies are required to invest at least 50% of their technical reserves in capital equipment bonds. This requirement diminishes the profitability of the insurance companies and their ability to offer their clients contracts with more advantageous conditions. Furthermore, it greatly reduces their freedom of action and constrains their holdings of shares and bonds. Indeed, the latter types of securities are in second place after capital equipment bonds in those companies' portfolios. In 1982, 30% of their technical reserves (which totaled TD 77 million) were held in the form of shares and bonds, compared to 30.5% in 1981. The restrictions placed on the insurance companies as regards their use of technical reserves should be made more flexible; in particular, compulsory subscriptions by them of capital equipment bonds should be eliminated or at least reduced.

10.45 The financial problems of the insurance sector are due primarily to the losses they incur in automobile insurance. The gross technical balance of automobile reinsurance showed a TD 2.6 million loss in 1982, and TD 2.5 million in 1981. This means that greater flexibility is urgently needed in the setting and adjustment of tariffs, and that a law should be enacted limiting the amounts that the courts can award to insured parties or members of their families in automobile accident cases. Automobile insurance is a heavy burden on the operating accounts of the insurance companies primarily because huge sums are awarded to insured parties by the courts, whereas premiums are regulated by the Ministry of Finance.

10.46 The recommendation in the Sixth Development Plan on the profession of stockbroker should be implemented. This occupation should be made more independent of the banks, which currently monopolize securities market intermediation. It would be well to encourage the establishment, as stockbrokers, of individuals or companies specializing in the stock market so as to increase competition with the banks in that area. Commercial banks are often uninterested in encouraging their customers to place their savings in securities rather than in deposits.

Protection of Investors

10.47 The Government should take all measures needed to develop the system for protecting savers who invest in securities listed on the Stock Exchange. Law 82-62 of June 30, 1982 on regulation of the professions of certified accountant and auditor strengthens their role and increases their legal accountability. It is therefore a positive step in the protection of investors, but a great deal remains to be done in this area. One key aspect of protection is to provide savers quickly with all financial and other information that may influence prices, in order to eliminate the advantage enjoyed at present by shareholders having privileged information. To this end, listed companies should be required to publish a balance sheet and provisional income statement at the end of every six months. It would also be worthwhile to set up a Securities Market Commission with responsibility for: (i) verifying the accuracy of published information and seeing to its correction if necessary; and (ii) approving the financial documents that must accompany all public offerings of new shares or bonds.

10.48 It is worth noting here that Law 69-13 of February 23, 1969 on the establishment of the Stock Exchange calls for bylaws to stipulate the actual operating procedures of the stock market; however, these bylaws have not yet been issued. Furthermore, there is as yet no legal framework for the issuance of bonds. There should be legal provisions particularly to regulate relationships between subscribers and issuers, and the position of bonds with respect to shares. These legal gaps should be corrected as soon as possible.

10.49 Stockbrokers are authorized to buy and sell shares of their own or their parent companies. This applies in particular to transactions in bank securities. Such operations should be strictly forbidden because they entail flagrant conflicts of interest and great risks of price manipulation with harm to investors.

Table A.2.1

TUNISIAN WORKERS ABROAD

1/ Tunisian workers' remittances

("Income from labor," item of the current balance of payments)
(millions of dinars)

1975	1978	1979	1980	1981	1982	1983	1984
58	92	116	129	1978	220	244	245 1/

1/ estimation

2/ Distribution of Tunisians abroad (1983)

France	258,000
Libya	86,000
W. Germany	26,000
Belgium	9,500
Britain	7,500
Iraq	7,300
Other	12,700
TOTAL	407,000

Table A. 2.2

MAXIMUM INTEREST RATES PAYABLE BY DEPOSIT BANKS
(percentage per year)

TYPES D'OPERATIONS	Sept. 6 1966	Feb. 10 1967	July 1 1971	Aug. 1 1973	April 7 1975	Sept. 1 1977	April 1 1981	March 1985
Demand deposits								
Individuals	2,00	1,75	1,00	0,50	0,50	2,00	2,00	2,00
Other	2,00	1,75	1,00	0,50	0,50	1,00	1,00	1,00
Special savings accounts								
less than 6 months	3,00	3,00	3,00	3,00	3,00	4,00	5,50	6,75
6 to 12 months	3,50	3,50	3,00	3,00	3,00	4,00	5,50	6,75
Over 12 months to less than 18 months	3,50	3,50	3,00	5,00	5,00	5,25	6,75	7,75
18 months to less than 2 years	3,50	3,50	4,50	6,25	6,25	6,50	7,75	8,75
2 years and over	3,50	3,50	5,00	6,50	6,50	7,50	8,75	9,75
Term accounts & registered certificates of deposits held by individuals								
3 months to less than 6 months	3,00	3,00	2,00	1,50	1,50	2,50	4,50	5,50
6 months to less than 12 months	3,50	3,50	2,75	3,00	3,00	4,00	6,00	7,00
12 months to less than 18 months	4,00	4,00	3,50	4,50	4,50	5,25	7,00	8,00
18 months to less than 24 months	4,00	4,00	4,25	6,00	6,00	6,50	8,00	9,00
24 months to less than 30 months	4,00	4,00	5,00	--	7,00	7,50	9,00	10,00
30 months to 60 months	4,00	4,00	5,50	--	7,00	7,50	9,00	10,50
Term accounts & registered certificates of deposit held by corporate bodies and bearer certificates of deposit								
3 months to less than 6 months	3,00	3,00	2,00	1,50	1,50	1,50	3,50	4,50
6 months to less than 12 months	3,50	3,50	2,75	3,00	3,00	3,00	5,00	6,50
12 months to less than 18 months	4,00	4,00	3,50	4,50	4,50	4,50	6,25	7,25
18 months to less than 24 months	4,00	4,00	4,25	6,00	6,00	6,00	7,50	8,50
24 months to less than 30 months	4,00	4,00	5,00	--	7,00	7,00	8,50	9,50
30 months to 5 years	4,00	4,00	5,50	--	7,00	7,00	8,50	10,00
Deposits in convertible dinars of Tunisian individuals residing outside Tunisia							9,00	10,50
Savings accounts for the promotion of projects							5,50	6,75
Savings accounts (investment)							3,50	4,50

Source: Central Bank of Tunisia

Table A. 4.1

ESSENTIAL CENTRAL BANK INTEREST RATES
(percentage per year)

TYPE OF OPERATIONS	Sept. 5 1966	March 21 1974	Sept. 1 1977	Jan. 5 1978	April 1 1981	April 1985
I. Discounts						
1. Commercial paper	5,00	5,00	5,75	5,75	7,00	9,25
2. Short-term financing						
Export prefinancing & mobilization of claims abroad	4,00	4,00	4,25	4,25	4,75	4,00
Advances/cereals oils and wines	5,00	5,00	5,75	4,25	4,25	5,50
Advances/merchandise other than cereals oils & wines	5,00	5,00	5,75	5,75	6,75	9,25
Financing of inventoreis	5,50	5,50	5,75	5,75	6,75	9,25
Short-term agric. credit guaranteed by mutual guarantee Cos.	--	--	--	--	2,00	4,75
Credit -- seasonal	4,00	4,00	4,00	3,75	3,75	4,50
Credit -- crops	5,50	5,50	6,00	6,00	6,00	7,25
Credit for prefinancing of public contracts	5,50	5,50	6,00	6,00	6,00	7,25
Advs/administrative claims without contract guarantee	5,50	5,50	6,00	6,00	6,00	7,25
Other financing	5,50	5,50	6,00	6,00	7,25	10,25
3. Medium-term financing						
Agricultural investments	5,00	4,25	4,00	3,50	3,50	5,50
Housing construction w/State guarantee	4,00	4,00	4,00	4,00	4,00	4,00
Capital outlays -- export companies	5,75	4,25	4,00	4,00	5,00	6,50
Capital outlays -- SMEs in dev. zones	5,75	4,25	4,00	4,00	5,00	4,75
Major industrial complexes in dev. zones	5,75	4,25	4,00	5,00	5,00	6,50
Investments in SMEs	--	--	--	--	6,75	6,50
Loans to artisans and small shops (1)	--	--	--	--	3,25	4,75
Investments in energy savings and new source of energy	--	--	--	--	--	4,75
Other	5,75	5,00	5,25	5,25	7,00	11,00
4. Long-term financing (2)						
Entreprises governed by special provisions	--	--	--	--	7,50	11,50
Agricultural credit					7,25	10,50

These references are explained in the methodology notes.

Tableau A. 4.2

ESSENTIAL INTEREST RATES PAYABLE BY DEPOSIT BANKS
(percentage per year)

TYPE OF OPERATIONS	September 1 1977				January 5 1978				April 1 1981				April 1985			
I - Overdrafts (minimum & maximum rates)	8.50		8.75		8.50		8.75		10.00		10.50		12.625			
	Rediscountable		N. Rediscount.		Rediscountable		N. Rediscount		Rediscountable		N. Rediscount.		Redisct.		N. Redisct.	
	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.
II-Discounted paper																
1. commercial operations																
In Tunisia	6,75	7,25	8,00	8,25	6,75	7,25	8,00	8,25	8,00	8,50	9,25	9,50	9,50	10,00	--	11,00
Abroad	5,50	6,00	6,25	6,50	5,50	6,00	6,25	6,50	6,00	6,50	6,75	7,00	6,00	6,50	--	--
2. Short-term financing																
Export pre-financing & mobilisation of claims abroad	5,50	6,00	6,25	6,50	5,50	6,00	6,25	6,50	6,00	6,50	6,75	7,00	6,00	6,50	--	--
Advances on cereals, oils & wines	7,00	7,50	8,00	8,25	5,50	5,50	--	--	5,50	5,50	--	--	6,75	6,75	--	--
Advances commodoties other than cereals, oils & wines	7,00	7,50	8,00	8,25	7,00	7,50	8,00	8,25	8,00	8,50	9,00	9,25	9,50	10,00	--	11,00
Financing of inventories	7,00	7,50	8,00	8,25	7,00	7,50	8,00	8,25	8,00	8,50	9,00	9,25	9,50	10,00	--	11,00
Short-term agric. credit guaranteed by mutual guarantee companies	--	--	--	--	--	--	--	--	6,00	6,00	--	--	6,75	6,75	--	--
Credit -- seasonal	6,00	6,50	6,75	7,25	6,00	6,00	--	--	6,00	6,00	--	--	6,75	6,75	--	--
Credit -- crops	7,25	7,75	8,50	8,75	7,25	7,75	8,50	8,75	7,25	7,75	8,50	8,75	8,00	8,50	--	9,50
Credit/prefin. of public contracts	7,25	7,75	8,50	8,75	7,25	7,75	8,50	8,75	7,25	7,75	8,50	8,75	8,00	8,50	--	9,50
Advances/administrative claims	7,25	7,75	8,50	8,75	7,25	7,75	8,50	8,75	7,25	7,75	8,50	8,75	8,00	8,50	--	9,50
Other financing	7,25	7,75	8,50	8,75	7,25	7,75	8,50	8,75	8,50	9,00	9,75	10,00	10,00	10,50	--	12,625
3. Medium-term financing																
Housing construction w/State guar.	5,50	5,50	--	--	5,50	5,50	--	--	5,50	5,50	--	--	5,50	5,50	--	--
Agricultural Investments	6,75	7,00	--	--	6,25	6,25	--	--	6,25	6,25	--	--	7,00	7,00	7,00	7,00
Capital outlays -- export cos.	6,75	7,00	--	--	6,75	7,00	--	--	7,75	8,00	--	--	8,00	8,00	8,50	8,50
Capital outlays -- decentralised companies in dev. zones	6,75	7,00	--	--	6,75	7,00	--	--	7,75	8,00	--	--	6,25	6,25	6,25	6,25
Major industrial complexes	6,75	7,00	--	-	6,75	7,00	--	--	7,75	8,00	--	--	8,00	8,50	--	--
Investments in SMEs	--	--	--	-	--	--	--	--	9,50	9,75	10,00	10,25	8,00	8,00	8,50	8,50
Credit to artisanas in small shops 1/	--	--	--	--	--	--	--	--	6,25	6,25	--	--	6,25	6,25	6,25	6,25
Invetsments in energy saving and new source of energy	--	--	--	--	--	--	--	--	--	--	--	--	6,25	6,25	6,25	6,25
Other	8,00	8,25	8,50	8,75	8,00	8,25	8,50	8,75	(9,50 (9,75	(9,75 (10,00	(10,00 (10,25	(10,25 (10,50	11,50	11,50	12,00	12,00
4. Long-term financing 2/																
Enterprises gov. by special provisions	--	--	--	--	--	--	--	--	10,50	--	--	--	12,00	--	12,00	--
Agricultural credit	--	--	--	--	--	--	--	--	10,50	--	--	--	12,00	--	12,00	--

These references are explained in the methodological notes.

Table A.4.3

TUNISIA
Financial Sector Study

Monetary Situation, 1979-83
(Millions of dinars; end of period)

	1979	1980	1981	1982	1983	1984
External holdings (net)	164,5	190,7	235,7	251,9	389,1	295,0
Central Bank (net) 1/	(197,1)	(239,3)	(294,4)	(315,8)	(462,9)	(384,7)
Deposit banks	(-32,6)	(-48,6)	(-58,7)	(-63,9)	(-73,8)	(-89,6)
Domestic credit	1.352,6	1.591,2	1.977,8	2.439,9	2.912,4	3.358,7
Credit to the State (net)	214,5	219,4	255,3	306,6	354,2	450,8
Central Bank	(-16,2)	(-15,6)	(-32,0)	(-29,7)	(-48,5)	(-36,0)
Deposit banks	(172,6)	(204,1)	(244,9)	(284,3)	(335,4)	404,6
Counterpart of postal checking deposit 1/	(25,7)	(30,9)	(42,4)	(52,0)	(67,3)	82,1
Credit to the economy	1.138,1	1.371,8	1.722,5	2.133,3	2.558,2	2.907,9
Central Bank	(18,9)	(19,4)	(28,1)	(48,0)	(72,3)	—
Deposit banks	(1.119,2)	(1.352,4)	(1.694,4)	(2.085,3)	(2.485,9)	—
of which: thru Central Bank resources	157,1	195,6	325,5	484,8	580,1	—
Money and quasi-money	1.219,2	1.445,1	1.724,8	2.050,5	2.430,6	2.710,4
Money	784,0	949,9	1.114,6	1.378,5	1.652,8	1.763,1
Currency outside banks	(265,1)	(299,6)	(342,8)	(440,0)	(533,3)	573,4
Demand deposits - Central Bank	(0,3)	(0,4)	(0,5)	(0,7)	(2,4)	0,8
Demand deposits - deposit banks	(492,9)	(619,0)	(728,9)	(885,8)	(1.049,8)	1.106,7
Postal checking deposits	(25,7)	(30,9)	(42,4)	(52,0)	(67,3)	82,2
Quasi-money	433,6	494,7	609,4	671,5	776,0	947,3
Special funds	133,0	150,4	269,5	380,2	578,3	—

1/ Deposits of private individuals and enterprises in postal checking accounts.

Source: Central Bank of Tunisia, Financial Statistics (May 1984).

Table A.4.4

TUNISIA
Financial Sector Study

Central Bank Holdings and Obligations, 1979-83
(Millions of dinars; end of period)

	1979	1980	1981	1982	1983	1984
External holdings 1/	199,8	219,8	258,8	261,4	378,4	335,5
Claims on the State	45,7	47,4	47,9	72,9	59,3	55,6
Claims of the economy	18,9	19,4	28,1	48,0	72,3	117,7
Claims on deposits banks and IFDCE	158,7	200,1	330,0	493,4	588,7	718,4
Portfolio	18,9	19,2	28,1	48,0	72,3	117,7
Holdings = Obligations	442,0	505,9	692,9	923,7	1.171,0	1.344,9
Monetary base 1/	299,1	337,7	426,4	524,8	617,1	698,7
Currency in circulation outside banks	265,1	299,6	342,8	440,0	533,3	573,4
Fiduciary money in deposit banks	8,1	7,5	9,3	10,1	11,6	18,5
Bank deposits 2/	25,6	30,2	73,8	74,0	69,8	106,0
Private sector deposits	0,3	0,4	0,5	0,7	2,4	0,8
External obligations	18,4	4,6	8,5	9,5	0,3	44,4
State deposits	29,5	63,0	79,9	102,6	107,8	91,6
Counterpart funds	2,1	1,9	4,4	19,6	16,9	18,5
SDR allocations	11,2	14,6	18,0	18,0	18,0	18,0
Capital accounts	52,0	62,8	72,1	110,4	132,3	186,2
Other Items (net)	29,7	21,3	83,6	138,8	278,6	287,5

1/ As defined in IMF, International Financial Statistics.
2/ Including term deposits of development banks.

Source: Central Bank of Tunisia, Financial Statistics (May 1984).

Table A.4.5

TUNISIA
Financial Sector Study

Holdings and Obligations of Deposit Banks 1979-83
(Millions of dinars; end of period)

	1979	1980	1981	1982	1983
Reserves	48,3	39,8	51,9	36,4	51,1
Cash	(8,1)	(7,5)	(9,3)	(10,1)	(11,6)
Deposits at Central Bank	(40,2)	(32,3)	(42,6)	(26,3)	(39,5)
External holdings 1/	41,4	52,5	83,6	120,4	169,9
Claims on the State	172,6	204,1	244,9	284,3	335,4
of which: Capital Equip. Bonds	(169,2)	(201,4)	(242,5)	(281,4)	(333,5)
Claims on the economy	1.119,2	1.352,4	1.694,4	2.085,3	2.485,9
of which:					
investment portfolio	(40,2)	(39,2)	(45,0)	(50,4)	(60,7)
Holdings = Obligations	1.381,5	1.648,8	2.074,8	2.526,4	3.042,3
Demand deposits	492,9	619,0	728,9	885,8	1.049,8
Obligations in quasi-money	433,6	494,7	609,4	671,5	776,0
External obligations	58,3	77,0	98,2	120,4	158,9
Long-term external borrowings	81,3	94,7	109,5	120,5	130,4
Counterpart funds	9,1	9,3	9,4	9,6	9,7
Funds loanable by the State	72,4	80,4	95,7	111,5	135,5
Aid from Central Bank	156,6	195,6	325,5	484,8	580,1
Capital accounts	85,7	96,3	133,7	157,7	191,7
Other items (net)	-8,4	-18,2	-35,5	-35,4	10,2

1/ As defined in IMF, International Financial Statistics.

Source: Central Bank of Tunisia, Financial Statistics (May 1984).

Table A.6.1
BENEFITS AVAILABLE TO INVESTMENTS IN THE AGRICULTURE AND FISHERIES SECTOR
(Law 82-67 of August 6, 1982)

IDENTIFICATION	LEGAL STATUS OF OPERATION	CATEGORY B	CATEGORY C
Nature of Promoter	ALL	Small and medium farmers and fishermen as defined in Decrees 82-25 and 83-224	Large-scale operators
Type of Project	ALL	Small and medium operators	Capital investment in the form of specific operations or integrated projects within the framework of high productivity projects.
Cost Ceiling	ALL	See order of April 27, 1983 issued by the Ministers of Planning, Finance and Agriculture, setting maximum amounts for small and medium agricultural projects	Unrestricted
FINANCIAL BENEFITS Cost of studies for the approved project up to a limit of 1% of the investment cost.	ALL	YES Ceiling of D 1,200	YES Ceiling of D 5,000
Subsidy in an amount calculated with reference to the rates laid down in the legal texts governing State incentives for development of agriculture and fisheries.	ALL	YES	
Loans to finance the investment at the rates laid down in the legal texts governing State incentives for development of agriculture and fisheries - 6% (short-term) - 6.25% (medium-term)	ALL	YES Minimum self-financing required: 10%	YES Minimum self-financing required: 10%
Subsidy on interest rate payable on bank loans.	ALL	YES	YES
Reimbursable grant repayable over 12 years, with a 5-year grace period	Young farmers and fishermen	YES The grant should not exceed 80% of the self-financing required interest rate: 3%	YES The grant should not exceed 50% of the self-financing required. It is limited to D 75,000. Interest rate: 4%
Real estate loan for the purchase of the purchase of the agricultural land covered by the project, carrying interest at 5%, repayable over 20 years, with a 3-year grace period.	Young farmers and fishermen	YES Maximum amount D 20,000. Only D 5,000 where land is being purchased from parents	
TAX BENEFITS Deduction of income reinvested in agriculture from the income tax base.	Individuals	YES 30% eligible	YES 30% eligible

Table A.6.1 (cont'd)
BENEFITS AVAILABLE TO INVESTMENTS IN THE AGRICULTURE AND FISHERIES SECTOR
(Law 82-67 of August 6, 1982)

IDENTIFICATION	LEGAL STATUS OF OPERATION	CATEGORY B	CATEGORY C
Deduction of income reinvested in agriculture from the tax base used in calculating the patente tax, the tax on income from noncommercial occupations, and the agricultural tax.	Bodies corporate	YES 50% eligible	
- Exemption from agricultural tax for individuals under the real system (régime réel) for a period of 7 years.	Individuals and partnerships	YES	YES
- Reduced rate of tax in years 8 through 10.		Reduced rate: 5%	Reduced rate: 8%
- Exemption for a 10-year period.		For the less-developed regions as defined in Decree 83-223	
- Exemption from patente tax for a period of 7 years.	Enterprises subject to the patente tax.	YES	YES
- Reduced rate of tax in years 8 through 10.		Reduced rates: 5%	Reduced rates: 8%
- Exemption for a 10-year r. iod.		For the less-developed regions as defined in Decree 83-223	
50% reduction in transfer taxes payable on purchase of agricultural land for the approved p oject.	All except limited liability companies (sociétés anonymes)	YES Subject to nonalienation over a period of 10 years from the date of the purchase contract, and commencement of the works within at most 2 years.	
Fixed-rate registration fee for documents establishing an enterprise and documents legalizing an increase in capital, over a 5-year period.	Bodies corporate	YES Fixed rate D 100 instead of the proportional fee of 1.4% of the amount of share capital.	
Exemption for the first 5 years from tax on securities income in respect of distributed projects.	Bodies corporate	YES Ceiling: 6% of nominal value of securities	
Exemption for the first 5 years from tax on securities income in respect of distributed profits.	ALL	YES	YES
SPECIAL BENEFITS Projects of special interest to the national economy.	ALL		YES The benefits listed on more favorable terms.
Nonresident promoters: - Transfer guarantee for capital in foreign exchange and related income. - Ease of establishment, in accordance with current legislation.	ALL		YES

Table A.7.1

TUNISIA
Financial Sector Study

Investments in Manufacturing Industry (1980-1983)
(million TD)

	1980			1981			1982			1983			1980 - 1983		
	Pub.	Pri.	Total	Pub.	Pri.	Total	Pub.	Pri.	Total	Pub.	Pri.	Total	Pub.	Pri.	Total
Agriculture and food	12,7	14,8	27,5	34,0	17,5	51,5	34,0	18,0	52,0	16,0	21,9	38,0	96,8	72,2	169,0
Construction materials ceramics and glass	24,7	13,5	38,2	40,2	16,7	56,9	43,7	20,9	64,6	64,4	24,0	88,4	173,0	75,1	248,1
Mech./elec. industries	6,3	14,3	20,6	11,4	15,0	26,4	18,0	24,3	42,3	22,6	41,6	64,2	58,3	95,2	153,5
Chemicals	13,1	2,5	15,6	33,1	3,2	36,3	43,4	4,6	48,0	56,1	8,9	65,0	145,7	19,2	164,9
Textiles and leather	2,0	13,7	15,7	4,3	18,7	23,0	4,3	21,3	25,6	8,0	26,8	34,8	18,6	80,5	99,1
Miscellaneous	2,2	11,0	13,2	2,3	13,8	16,1	5,2	18,3	23,5	4,5	20,0	24,5	14,2	63,1	77,3
Total	61,0	69,8	130,8	125,3	84,9	210,2	148,6	107,4	256,0	171,7	143,2	314,9	506,6	405,3	911,9
Total (%)	46,7	53,3	100,0	59,6	40,4	100,0	58,0	42,0	100,0	54,5	45,5	100,0	55,5	44,5	100,0

Source: Ministry of Planning

Table A.7.2

TUNISIA
Financial Sector Study

Distribution of Approved Projects According to Amount of Investments
(new projects only)
1983

	I less than TD 250,000	%	250,000≤I≤500,000	%	500,000≤I≤1,000,000	%	I more than TD 1 million	%	TOTAL
Number of projects	1,516	83.9	166	9.2	54	3.0	71	3.9	1,807
Investments (TD mln)	99	16.4	61	10.1	37	6.1	406	67.4	603
Jobs	18,895	58.0	3,812	11.7	2,215	6.8	7,656	23.5	32,578
Average cost per job (TD)	5,240	n.a.	16,010	n.a.	16,700	n.a.	53,030	n.a.	18,500
Average cost per project	65,300	n.a.	367.500	n.a.	685,200	n.a.	5,720,000	n.a.	333,702
Average employment per project	12.5	n.a.	23	n.a.	41	n.a.	108	n.a.	18

n.a. = not applicable

Source: A.P.I.

Table A.7.3

TUNISIA
Financial Sector Study

Investments Project Approved by API
(million TD)

	1979			1980			1981			1982			1983		
	Proj.	Invest.	Employ.	Proj.	Invest.	Employ.	Proj.	Invest.	Employ.	Proj.	Invest.	Employ.	Proj.	Invest.	Employ.
Agric. & food	322	47.4	6631	424	93.2	6632	486	77.4	8492	606	125.3	9106	398	116.8	5407
Constr. materials ceramics & glass	[illegible]	143.8	4790	241	53.1	4324	192	49.3	3648	239	153.2	5078	247	193.1	4993
Mech/elec. inds.	235	56.0	7118	253	98.5	7015	288	132.4	8197	283	142.9	9535	234	205.3	7057
Chemicals	33	43.9	704	66	89.9	2095	51	102.5	1737	74	146.7	2208	72	51.2	1061
Textiles & Leather	323	29.1	11309	357	62.0	11659	491	48.2	13392	570	59.0	12847	546	78.3	11151
Miscellaneous	402	37.9	7320	372	45.5	6362	371	53.1	5140	435	66.6	6426	310	49.9	4063
Total	1498	358.1	37872	1713	442.2	38087	1879	462.9	40606	2207	693.7	45200	1807	694.6	33732

Proj. - Number of projects

Invest. - Investments

Table A.7.4

TUNISIA
Financial Sector Study

Exports of Manufactures
(million TD)

	1980	1981	1982	1983	Avge. Rate of Income
Textiles & leather	170.4	197.8	230.0	270.0	16.6
Chemicals	119.7	157.5	185.0	223.0	23.0
Mechanical, electrical	30.7	40.0	55.0	65.0	28.4
Other	8.7	27.2	26.3	37.0	62.0
Total manufactures	329.5	422.5	496.3	595.0	21.8
Total merchandise exports	970.0	1213.3	1175.0	1310.0	10.5
Manufactures (%) / Total merchandise exports	34.0	34.8	42.2	45.4	

Source: Ministry of Planning