TUNISIA

Debt Service / Country Risk Analysis Update

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RECENT ECONOMIC DEVELOPMENTS 1/

Tunisia's economy grew at a fast pace during the 1970s. Between 1971 and 1981, annual real economic growth averaged 6.3 percent. Part of Tunisia's success was due to the development of its oil resources and exports of petroleum products, which were negligible in 1972 and increased to over 50 percent of exports of goods by the beginning of the 1980s. Other sectors of the economy developed as well, and manufacturing industry, especially construction materials and textiles, grew very rapidly.

The beginning of the Sixth Plan (1982-1986) was marked by a severe slowdown in economic activity. Unfavorable weather conditions, which depressed agricultural production, coupled with declining oil receipts, severely curtailed economic growth in Tunisia (see Table 1). Instead of the 6 percent forecast in the context of the Sixth Plan, no growth was realized in 1982. The economy recovered slightly in 1983, with a continued decline in tourism and low growth in agricultural production being offset by a good performance of manufacturing industry and an increase in petroleum and phosphate exports, leading to a growth rate of 4.8 percent. On the expenditure side, the recovery was concentrated in consumption, especially of the private sector.

In 1984, the recovery continued across most sectors, led by a surge in agricultural production and the continued strong performance of the manufacturing industry, especially of food processing, with economic growth reaching 5.4 percent. The petroleum sector, however, continued to weaken, and growth in textiles, chemicals, and construction slowed down considerably. Real consumption growth dropped below the increase in real GDP, while investment rebounded. Domestic savings, however, grew at a rate below that of nominal GDP. The lower rate of domestic savings was due mainly to lower household saving and led to a renewed increase in the current account deficit, which reached 10.8 percnt of GDP in 1984 (see page 4 below). The volume of imports, on the other hand, increased sharply exceeding the small increase in export volume.

Prospects for 1985 were for a slowdown in economic activity. Economic growth was forecast to be about 4 percent, mainly due to the projected continued deterioration of phosphate production, a decline in output in the food processing industries, lower crude oil output, and a weakening construction sector. These negative developments were to be offset by a record cereal crop and an expected strong recovery in the tourist sector. However, by the end of 1985 the price of Tunisian oil had dropped significantly and the cereal crop now appears to have been overestimated. Thus the actual rate of economic growth registered for 1985 may be less than originally anticipated. For 1986 real economic growth is expected to

1/ From: IMF, "Tunisia: Recent Economic Developments, " SM/85/281, October 24, 1985. Other summaries of recent economic developments in Tunisia may be found in AID/Tunis' forthcoming CDSS submission and in the World Bank, "Tunisia Country Economic Memorandum; Midterm Review of the Sixth Development Plan (1982-1986), Report No. 5328-TUN, Oct. 85

Table 1. Tunisia: Sectoral Distribution of Real GDP Growth, 1981-85

(In percent)

	1981	1982	1983	1984	1985 Budg. Econ.	1985 Rev.
Agriculture and fishing	8.8	-9.9	2.7	11.6	1.6	9.1
Mining	8.2	-4.1	17.0	-3.6	5.7	-5.7
Hydrocarbons, electricity, and water	-2.9	-3.3	7.6	-0.9	-1.3	-2.5
Manufacturing industry	12.8	2.8	8.1	8.6	8.2	6.0
Food processing	13.4	-7.0	2.8	19.1	-0.2	0.8
Construction materials and glass	17.2	1.4	14.1	6.2	10.8	8.1
Mechanical and electrical industries	16.2	9.5	7.2	9.5	12.5	7.4
Chemical and rubber industries	7.3	5.7	12.5	3.2	16.8	6.2
Textiles, clothing, and leather	11.6	3.6	6.1	2.5	6.1	7.2
Woodwork, paper, and other	10.8	12.3	10.9	9.9	10.8	9.0
Construction and public works	14.3	3.0	—	1.2	-1.6	-2.4
Services	7.1	2.6	3.5	4.6	3.7	3.8
Transport and telecommunications	5.2	2.2	8.2	11.1	8.9	8.2
Tourism	3.6	-9.7	-6.9	—	6.0	8.3
Commerce and other services	5.5	3.6	5.0	5.4	3.5	3.8
Government wages and salaries	8.7	4.9	4.2	4.1	3.9	3.9
GDP (at market prices)	5.5	—	4.8	5.4	3.5	4.0
Nonhydrocarbon GDP	6.6	0.5	4.5	6.2	4.3	4.8

Source: IMF, "Tunisia: Recent Economic Developments," SM/85/281, October 24, 1985 slow down even further as oil prices are projected to remain depressed and the agricultural sector has been hit by a severe drought (see analysis of External Sector on page 4).

POLICY OBJECTIVES AND REFORM 2/

The Sixth Plan chose an ambitious set of objectives requiring complex and far reaching policy reforms. Under the Plan, the main priority policy objectives were to restrain demand, promote non-oil exports, stimulate employment and encourage regional development in order to prepare the Tunisian economy for the post oil boom era. These objectives were to be achieved within the framework of a gradual liberalization of the economy including the adoption of such key policy reforms as reducing the cost of labor (wage policies), cutting back on the growth of domestic consumption (lowering subsidies) and the rate of investment, and adjusting the real rate of exchange. As of the close of 1985, the GOT had made some progress towards meeting the above stated objectives. Most of the requisite policy reforms, however, were either never implemented, or done so with such considerable delay that the necessary fundamental readjustment of the Tunisian economy has been postponed. This has increased both the economic costs of the policy reforms and, above all, the urgency to implement them, so as to avoid major balance of payments difficulties. Spurred on in large part due to the recent and dramatic fall in petroleum revenues, however, GOT policy makers have begun to move on some of the more critical of the above reforms, in particular calling in 1986 for a large reduction in subsidies and a significant reduction in investment spending. 3/

2/ From: World Bank, "Tunisia Country Economic Memorandum; Midterm Review of the Sixth Development Plan (1982-1986)," Report No. 5328-TUN, October 1985

3/ It is also speculated that the GOT will soon initiate a gradual devaluation of the Dinar

EXTERNAL SECTOR

A. Balance of Payments

Since 1981, Tunisia's overall balance of payments has steadily deteriorated (see Table 2). In 1981, the country enjoyed a surplus of SDR 85 million. 4/ However by 1984, the balance of payments had reached a deficit of SDR 146 million, an increase of over 130 million from the previous year. The primary causes behind this deterioration in Tunisia's balance of payments have been a stagnation of export revenues, a fluctuation of service earnings from tourism and a reduction in worker's remittances. Correspondingly, Tunisia's current account deficit increased significantly from SDR 585 million in 1983 (7.6 per cent of GDP) to SDR 846 million in 1984 (10.8 percent of GDP).

Most of the increase in the current account deficit occurred in the trade account. Exports stagnated in SDR terms, due in particular to a poor performance of phosphates, chemical products, textiles and the continued weakening of petroleum exports. Energy exports fell by 2.5 percent and represented 34.4 percent of export values, compared with a peak of 53.3 percent in 1981. The growth of non-energy exports (volume) increased by 4.6 percent but performance was varied with buoyant performances registered for agricultural exports and mechanical and electrical goods versus declines in SDR terms for exports of phosphates (and derivatives) and textiles.

In 1984 imports grew strongly by 6.4 percent in SDR terms, following two years of decline in part reflecting a rebound of imports of raw materials and semi-finished goods which had been subject to administrative tightening in 1983.

For both 1985 and 1986, export revenues were officially projected to rise by 0.8 percent in SDR terms. However these figures were based on oil price projections of US$ 27.50 and US$ 25 per barrel (down from US$ 30 in 1983). By December of 1985, the price of oil had fallen to US$ 23 and by January 1986 it declined further to US$ 15 per barrell where it has since stabalized for the time being. It is estimated that Tunisia stands to lose more than US$ 100 million worth of foreign exchange in the coming year due to the fall in oil prices alone. Moreover, export revenue projections were based on the assumption that agricultural exports would continue to exhibit strong growth performance. The Tunisian agricultural sector, however, was hit by a severe drought this past winter and as a result agricultural export revenues are expected to decline significantly.

4/ The Special Drawing Right (SDR) is an average of world trading currencies and is, therefore, a better measure of international monetary transactions than is local currency in periods of wide currency fluctuations.

Table 2. Tunisia: Balance of Payments Summary, 1981-85

(In millions of SDRs) 1/

	1981	1982	1983	1984	1985 Proj.
Goods, services, and transfers					
Exports, f.o.b.	2,082	1,793	1,741	1,754	1,769
Imports, f.o.b.	3,042	2,915	2,752	2,945	2,795
Trade balance	-960	-1,122	-1,011	-1,191	-1,026
Services and income (net)	354	346	338	284	336
Of which: tourism receipts	(507)	(521)	(537)	(449)	(489)
interest on external debt	(-179)	(-185)	(-195)	(-237)	(-253)
Transfers (net)	55	81	88	61	35
Of which: receipts from workers' remittances	(306)	(337)	(336)	(309)	(289)
Current account	-551	-695	-385	-846	-655
Capital movements (net)					
Grants	17	17	24	28	24
Direct and portfolio investment	311	364	209	201	189
Medium- and long-term borrowing (net)	234	285	323	320	312
Of which: Central Government	51	54	109	126	...
Short-term capital 2/	67	53	15	150	—
Capital account	629	720	571	700	525
Allocation of SDRs	6	—			
Overall surplus or deficit (-) 3/	83	25	-14	-146	-130

Source: IMF, "Tunisia: Recent Economic Developments," SM/85/281, October 24, 1985

1/ The figures are based on transactions as recorded by customs statistics, and differ from those in Appendix Table XVI which are based on settlements. Dinar values were converted at the following average annual exchange rates: for 1981, D 0.582 per SDR 1; for 1982, D 0.652 per SDR 1; for 1983, D 0.725 per SDR 1; for 1984, D 0.795 per SDR 1; and for 1985, D 0.848 per SDR 1.

2/ Including commercial banks, and errors and omissions.

3/ Including changes in reserves and valuation adjustments.

Imports for 1985 were projected to decline by about 7 percent in volume reflecting a tightening once again of administrative controls especially on investment goods and a reduction in grain imports. However while import restrictions on certain capital and a consumer goods are envisioned to remain in effect, imports of grain will rise sharply during 1986 to offset the damaging effects of the drought on Tunisia's cereal crop.

There was a sharp decline of 16 percent in the surplus of net services and income in 1984, which decreased to SDR 284 million. Receipts from tourism fell for the first time from 7.0 percent of GNP in 1983 to 5.7 percent in 1984. Tourism receipts were anticipated to rise again in 1985 but this was before the October bombing. At the same time, interest payments on the external debt increased by 21.5 percent to reach 3.0 percent of GNP in 1984. The increase in Tunisia's foreign indebtedness will result in a further rise in interest payments on the external debt (see below). Worker's remittances also declined during the early 1980s and are likely to continue to fall given the lack of emmigration possibilities and the returning home of Tunisian workers abroad, especially from Libya.

In sum, given the recent percipitous fall in the price of Tunisian oil, the current drought, the increase of interest payments on external debt, the decline in workers remittances and the effect of the October bombing on tourism, Tunisia is projected to continue to run relatively large balance of payments deficits over the next several years. However, as noted above, the GOT has begun to institute policy reforms designed to ameliorate the country's economic condition. These reforms should thus, if rigorously applied, result in a stabalization and eventual reduction of the country's balance of payments deficit.

B. External Debt

The deterioration of Tunisia's balance of payments has resulted in a large increase in the country's resource gap from 5.4 percent of GDP over the period 1977-1981 to a relatively high 10.4 percent in 1982-83. Thus, in spite of substantial direct private foreign investments, Tunisia had to step up net public foreign borrowing more than two and a half times between 1980 and 1983 from an annual average of TD 126 million (US$ 186 million) to TD 330 million (US$ 486 million); close to one-third of this new borrowing was short-term. As a result, Tunisia's outstanding external medium-and long-term debt increased at an average rate of 12 percent over the period 1980-1984 (see Table 3). By the end of 1984, Tunisia's total outstanding external debt stood at an estimated SDR 3,708.5 million. The ratio of total outstanding debt to GNP also increased steadily over the period reaching 50.1 percent of GNP by 1984 (compared to 35.1 percent in 1980). Projections through 1991 indicate that this ratio is likely to remain fixed around the 50 percent mark.

Table 3. Tunisia: Outstanding External Medium- and Long-Term Debt, 1980-84 1/

	1980	1981	1982	1983	1984
	(In millions of SDRs; end of year)				
By lender	2,321.3	2,654.1	2,974.1	3,304.0	3,708.5
Official loans (including international organizations)	1,405.6	1,692.1	1,946.4	2,108.5	2,166.2
Private loans 2/	915.7	962.0	1,027.7	1,195.5	1,542.3
By borrower	2,321.3	2,654.1	2,974.1	3,304.0	3,708.5
Central Government	1,638.6	1,647.8	1,656.4	1,843.6	...
Excluding amount on-lent to public enterprises	(914.2)	(1,142.9)	(1,227.9)	(...)	(...)
Public and private enterprises	682.7	1,006.3	1,317.7	1,460.4	...
	(As percent of total)				
Official loans	60.5	63.8	65.4	63.8	58.4
Private loans 2/	39.5	36.2	34.6	36.2	41.6
Central Government	70.6	62.1	55.7	55.8	...
Public and private enterprises	29.4	37.9	44.3	44.2	...
Outstanding debt/GNP	35.1	38.2	41.5	45.0	50.1
Average terms on new external debt commitments 3/					
Average maturity (years)	17.4	15.6	17.5	13.9	11.8
Average interest rate (in percent)	6.8	8.1	7.6	8.2	9.5
Grant element (in percent)	22.7	12.6	15.8	...	...
Average grace period (years)	5.0	3.6	4.1	2.0	2.0

Source: IMF, "Tunisia: Recent Economic Developments," SM/85/281, October 24, 1985

1/ Includes debt without government guarantee and private debt. Debt with maturity of less than 12 months is excluded.
2/ Suppliers' and buyers' credits and credits from private financial institutions.
3/ World Bank estimates.

Since 1980, the part of the external debt held by the central government has fallen, while that held by the enterprise sector has increased. In other words, net borrowing by the government has declined. Borrowing from official sources, relative to private creditors, increased from 1980-1982 from 60.5 to 65.4 percent of outstanding debt. From 1983-1984, however, borrowing from official sources declined from 63.8 to 58.4 percent reflecting in part the aforementioned upsurge in government short-term borrowing on international (private) financial markets.

As a result of this upsurge, the average interest rate on new debt contracted during 1984 is estimated to have increased to 9.5 percent, compared to 8.2 and 6.8 percent for new committments in 1983 and 1980 respectively. The average maturity has declined from 17.4 years in 1980 to 11.8 years in 1984, and the average grace period is now 2 years compared with 5 years in 1980. Loan terms on new committments from official creditors, however, continue to be much more favorable from those entered into with private creditors especially with regards to average maturity and grace period (As of 1983: 8.3 interest rate, 14.2 years maturity and 4.6 years grace period).

The increase in government short-term borrowing has also had a major impact on the country's level of debt service payments. Tunisia's service payments on medium and long-term external debt increased at an average annual rate of 10.4 percent from 1981-1984 (see Table 4). Moreover, the rate of increase in service payments has been increasing - from 2.3 percent between 1981-1982 to 15.9 percent between 1983-1984. Similarly, Tunisia's debt service ratio has grown steadily; from 13.6 percent of total current receipts from goods, services, and transfers to an estimated 20.9 percent in 1985.

Given the fall in revenues from petroleum and agricultural exports, tourism and worker's remittances, Tunisia will be forced to borrow more heavily on the international markets over the next several years than originally anticipated. As a result, for the period 1986-1991, the rate of growth in debt service payments is projected to continue to increase accounting for some 6-8 percent of annual GNP (high by middle-income country standards) while the debt service ratio is expected to reach 26 percent (still below the 30 percent average for developing countries). 5/

The above projections and figures represent significant increases over past levels of indebtedness. However, despite the government's recent upsurge in short-term borrowing, Tunisia's foreign debt is still overwhelmingly long-term with debt service obligations distributed evenly over time. The government has also traditionally pursued very cautious borrowing policies; preferring whenever possible to drawdown on its own reserves rather than secure new loans and avoiding borrowing on

5/ These figures come from the forthcoming USAID/Tunis CDSS submission

Table 4. Tunisia: Service Payments on Medium- and Long-Term External Debt, 1981-85 1/

	1981	1982	1983	1984	1985 Proj.
			(In millions of SDRs)		
Total service payments	458.2	468.7	519.5	602.0	654.6
Amortization	278.9	283.9	324.7	364.7	400.9
Central Government	(76.8)	(98.9)	(120.0)	(182.3)	(201.8)
Public and private enterprises	(202.1)	(185.0)	(204.7)	(182.4)	(199.1)
Interest	179.3	184.8	194.8	237.3	253.5
Central Government	(68.0)	(85.4)	(90.0)	(120.2)	(137.5)
Public and private enterprises	(111.3)	(99.4)	(104.8)	(117.1)	(116.0)
			(In percent)		
Ratio of service payments to exports of goods, services, and transfers	13.6	14.7	16.6	19.6	20.9

Source: IMF, "Tunisia: Recent Economic Developments," SM/85/281, October 24, 1985

1/ Includes debt without government guarantee and private debt.

non-concessional terms. Moreover, the economic policy reforms currently being undertaken by the government should help reduce the pressure on the country's external debt service structure. In consequence, while Tunisia is going to experience difficulties in servicing its external debt in the short-run, the danger of a long-run balance of payments or debt service crisis occuring is minimal (note that as of this writing no mention has been made of rescheduling Tunisia's debt) and Tunisia will thus remain a creditworthy country for long-term foreign investment. As such, the potential risk in providing HG loan assistance to Tunisia is, in our opinion, acceptable.

IMPACT OF HG PROJECT ON TUNISIAN EXTERNAL DEBT AND ECONOMY

The proposed US$ 46 million HG project will only marginally increase Tunisia's debt service payments while at the same time providing important support for the country's efforts to improve its economic fortunes. It is anticipated that 4 HG loans will be made to the GOT under the proposed project according to the following schedule:

Year	1986	1987	1988	1989
HG Loan Amount (in US$ millions)	12.0	14.0	10.0	10.0

It is difficult to predict the exact interest rates that the GOT will have to pay for these proposed loans since: 1) they will be determined by the US capital markets at the time the respective loan agreements are signed and 2) the rates will be subject to potentially significant fluctuations over the proposed borrowing period. In view of these difficulties, two interest rates are used to project the HG project's impact on Tunisia's debt service payments; the current market fixed interest rate of 9.5 percent and a fixed rate of 12.5 percent which roughly corresponds to the average rate for HG loans over the past several years. For either scenario, loan maturities and grace periods on principal repayment would reflect typical HG terms of 30 and 10 years respectively. Calculations indicate that if a 9.5 percent rate is used, the HG project will add in its first years approximately US$ 1.14 million to Tunisia's total debt service and by the 4th year this figure would increase to US$ 4.37 million. For a 12.5 percent rate, the figures are US$ 1.5 million and US$ 5.75 million respectively. Using the GOT's estimated total service payments on medium and long-term external debt for 1985 of US$ 650 million as a base, the above figures translate into only a .18 percent increase for 1987 and .67 increase for 1990 in Tunisia's total debt service payments at the 9.5 percent interest rate and increase of .23 and .88 percent at the 12.5 interest rate. If the GOT obtains the proposed HG loans at variable instead of fixed interest rates then the impact on Tunisia's debt service payments is even more negligible.

The fact also remains that despite Tunisia's growing debt service problems, the GOT will have to continue to borrow funds in order to meet previous committments and obtain the necessary goods and services to revitalize the economy. In face of the GOT's growing reliance on short-term borrowing, the World Bank and IMF have both recommended that the majority of new loan committments taken on by the GOT over the next several years be of a concessional nature. With their typical 30 year maturity and 10 year grace period on pricipal repayment, loans secured under the HG Program meet the IMF's criteria for loan concessionality.

In addition, given that approximately 96 percent of the costs incurred under the proposed HG project will be in local currency, roughly US$ 44 million worth of foreign exchange will be available to the GOT which it can use for balance of payments support. Such 'untied' dollars having a very long repayment period will be especially helpful in servicing the GOT's higher cost short-term external debt which it has been incurring at an increasing rate. The foreign exchange proceeds from the HG loans can also be invested in productive economic activities expected to yield rates of return in excess of the marginal cost of capital.

Moreover, most of Tunisia's foreign exchange needs are represented by imports denominated in european currencies which are still relatively weak against the dollar. This makes it, at least in the short-term, beneficial for the GOT to contract a dollar denominated HG loan.

Finally, the existing GOT development plan gives priority to employment generation and income distribution through regional development. Directly and indirectly, the proposed HG project can further both of these objectives. Housing is typically a labor intensive activity and thus HG funds will result in added job creation. The fact that the HG project will be carried out in secondary cities will further the government's efforts to selectively decentralize investments, bringing about a more equitable distribution of income.

In summary, a combination of factors - the competitive rates and terms on HG loans, the ability to further the country's development goals, the relative strengh of the US dollar and the marginal impact of HG loan repayments on the country's total debt servicing - makes a HG loan a relatively attractive source of needed foreign capital to the GOT. From USAID's perspective, despite the downturn in Tunisia's economic performance, the country's overall debt service structure remains within tolerable limits. Moreover, both the GOT's traditionally cautious management of its external debt and its recent adoption of substantative austerity measures reflects the country's ability to repay a HG loan and thus significantly reduces the level of risk associated with providing HG assistance. As such, USAID/Tunis believes that AID will not be taking any extraordinary risks in issuing its guaranty under the proposed project.