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Ex-ante evaluation statement on EU macro-financial assistance

to the Republic of Tunisia

Accompanying document to the

Proposal for a Decision of the European Parliament and of the Council providing macro-financial assistance to the Republic of Tunisia

Ex-ante evaluation statement

EU Macro-financial assistance to the Republic of Tunisia

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Annex I: EEAS Assessment on Political Reforms in Tunisia

1. Problem analysis and needs assessment

1.1. Introduction

The Tunisian economy has been negatively affected by the domestic unrest that followed the 2011 revolution, regional instability (notably the war in Libya), and a weak international environment, particularly in the euro area, with which Tunisia maintains close trade and financial links. The economy experienced a recession in 2011 and, despite the moderate economic recovery witnessed in 2012, when tourism and foreign direct investment (FDI) rebounded and economic activity picked up, **the macroeconomic situation remains very vulnerable**. In particular, the fiscal and balance of payments situation has deteriorated quite markedly, generating important financing needs.

At the same time, following the ousting of President Ben Ali on 14 January 2011, the country is taking significant steps towards the establishment of democratic mechanisms, including the organisation of free elections and the creation of a National Constituent Assembly. Although the political transition has not been without difficulties and episodes of instability, the process is expected to result in the approval of a new Constitution and the organisation of new elections in the first half of 2014.

Against this background, the Tunisian authorities reached in mid-April 2013 an agreement with the International Monetary Fund (IMF) staff on a **24-month Stand-By Arrangement (SBA) in the amount of USD 1.75 billion** (400% of quota), which was approved by the IMF Board in June. The aim of the SBA is to support the government's economic reform programme, reduce economic vulnerabilities and foster sustainable and inclusive growth.

In this context, the Tunisian government **requested Macro-Financial Assistance (MFA) from the EU in the amount of EUR 500 million** on 28 August 2013, with a portion in the form of a grant (see the request letter in Annex). The European Commission submits to the European Parliament and the Council a proposal to grant a MFA to the Republic of Tunisia amounting to a **maximum of EUR 250 million.** The assistance would take the form of **medium-term loans**, with no grant component being envisaged given that Tunisia does not meet the eligibility criteria for the use of grants in MFA operations.

The proposed EU MFA would help Tunisia **cover part of its residual external financing needs for the period 2014-15 in the context of the IMF programme, estimated at USD 3.0 billion**. It would reduce the economy's short-term balance of payments and fiscal vulnerabilities, while supporting the adjustment and reform programmes agreed with the IMF and the World Bank, as well as the reforms agreed under the EU's budgetary support operations, in particular the State Building Contract *Programme d'Appui à la Relance* (PAR), which is financed in part by the EU's Support for Partnership Reform and Inclusive Growth (SPRING) programme.

The proposed MFA is in line with the aims of the G8's Deauville Partnership initiative and the orientations of the new European Neighbourhood Policy (ENP). It would signal to the other countries in the region that the EU is ready to support countries like Tunisia, embarking on political reforms, in moments of economic difficulties.

1.2. Tunisia's macroeconomic situation and structural reform challenges

After a severe recession in 2011, when the economy contracted by 1.9% due to the domestic political unrest and the Libyan conflict, a moderate recovery started in 2012 despite an adverse international and domestic environment, with real **GDP growth** picking up to an estimated 3.6%, helped mainly by the rebound in tourism and FDI inflows. Despite the promising pick-up in manufacturing activity and increase in tourism shown by mid-2013, the ongoing political stalemate, lower than expected growth in the EU (Tunisia's main trading partner) and emerging markets, and a bad harvest have slowed down economic activity. The IMF recently revised its forecast for GDP growth in 2013 to 3% from 4%. The growth forecast for 2014 has also been revised downwards from 4.5% to 3.7%, with risks strongly tilted to the downside reflecting the domestic political situation.

Unemployment remains a key concern with an unemployment rate of 15.9% at end-June 2013 compared with 13.5% before the revolution. Unemployment among young graduates is on average 20.9% for men and 43.5% for women. These figures have to be seen in the context of a highly segmented labour market with overall low employment rates, in particular for women, and a high share of informality.[1]

There have been **inflationary** pressures since early 2012, with year-on-year inflation accelerating from 4.1% at the end of 2011 to 6.4% by April 2013. This was largely explained by increases in administered energy prices, as the government made some first steps to reduce fuel subsidies and adjust electricity tariffs, and by higher food prices. The latter in turn reflected increased food demand from Libyan refugees and returning Tunisian migrant workers, as well as disruptions in supply distribution chains. However, inflation has dropped back to 5.7% (and core inflation to 4.4%) by September and is expected to remain stable at around that level.

Monetary policy was accommodative during 2011 and the first months of 2012 in response to the existence of a large output gap and relatively stable core inflation. However, as inflation started to accelerate and external and fiscal balances further deteriorated, the central bank (Central Bank of Tunisia – CBT) took some tightening measures, increasing its benchmark policy rate by 50 bps since August 2012 (to 4%). The IMF recently recommended that the CBT sends a strong signal by raising rates to contain underlying inflationary tensions. The creation of a monetary policy committee in January 2013 should facilitate the forward-looking assessment of inflationary pressures.

Regarding the **public finances**, the government adopted in May 2012 a supplementary budget foreseeing a deficit of 6.6% of GDP for the year (3.5% of GDP in 2011) to enable higher spending on development projects and job creation, although a lower deficit of 5.4% of GDP was finally realised, broadly due to higher-than-expected revenues and under-execution of the investment budget. The IMF programme envisaged a modest fiscal adjustment for 2013, with the fiscal deficit targeted to increase to 7.3% of GDP, broadly reflecting the cost of the planned recapitalisation of banks and the repayment of arrears. However, recent trends suggest that in the absence of new measures, there will be a considerable fiscal slippage (the deficit is now projected to reach 8.4% of GDP unless corrective measures are taken). The main reasons for the fiscal slippage are lower tax revenues than expected, reflecting weaker than assumed economic growth, and higher current expenditure (mainly energy subsidies and

[1] The World Bank estimates that around 38% of GDP comes from the informal economy in Tunisia.

the wage bill, partly due to a recruitment overshoot in the Ministry for Security). In addition, the government has accumulated substantial payment arrears. Although there is no proper stock inventory covering all public entities, arrears seem to have risen by at least 26% since June.

This fiscal deterioration in 2013 is expected to be partially compensated, like last year, by a lower execution rate of **public investments** (only 30% has been executed to date, better than in 2012, but worse compared to 2010 when the execution rate reached 65%). On current trends, public investment is expected to reach only 5% of GDP in 2013, compared with pre-revolution levels of 7-8% of GDP. In addition, a supplementary budget announced in late October proposes to use some of the proceeds from the partial privatisation of Tunisia Telecom (USD 500 million) to compensate for the delay in the emission of Sukuk bonds (see below) in partially financing the budget deficit.

Table 1: Tunisia– Selected macroeconomic indicators, 2010-2014

	2011	**2012**	**2013 Proj.**	**2014 Proj.**	**2015 Proj.**
	(Annual percentage change, unless otherwise indicated)				
National Accounts					
Real GDP growth	-1.9	3.6	3.0	3.7	4.8
Population (million)	10.7	10.8	10.9	11.1	11.2
Consumer price index, period average	3.5	5.6	6.0	4.7	4.7
GDP per capita (USD)	4.350	4.212	4.483	4.576	4.689
Unemployment rate (in per cent)	18.9	16.7	---	---	---
	(In per cent of GDP, unless otherwise indicated)				
Consolidated government operations					
General Government gross debt (inc. Pension Fund)	44.0	44.3	46.6	50.6	50.0
o/w external debt	25.5	27.6	29.7	33.9	34.2
Revenue and grants	24.7	23.9	24.1	22.9	23.5
Expenses	27.9	28.7	31.0	29.7	29.0
Overall fiscal balance	-3.2	-4.8	-6.9	-6.8	-3.4
Overall fiscal balance excluding grants	-3.5	-5.7	-7.3	-7.0	-3.6
External sector					
Current account balance	-7.3	-8.2	-8.2	-6.4	-5.3
Current account balance excluding grants	-7.6	-9.0	-9.0	-7.0	-6.0
Gross international reserves, end of period (USD bn)	7.5	8.6	7.5	8.9	9.9
- In months of next year's imports of goods/services	3.4	3.9	3.3	3.7	3.8
Foreign direct investment, net	0.4	1.7	0.9	1.0	1.4
Nominal exchange rate (average - dinar/USD)	1.41	1.57	---	---	---

Sources: IMF staff estimates

The draft **Budget Law for 2014** has not yet been approved due to the political impasse, but the IMF is calling for an additional adjustment of about 2 percentage points of GDP in order to reach the programmed deficit target of 6.4% of GDP, and is warning the authorities against postponing the necessary measures to a complementary budget, which would only reduce the room for manoeuvre given the political calendar in 2014. Corrective measures being proposed by the IMF include: (i) adjusting energy tariffs (focusing on industrial and commercial users) while developing a better targeted social safety net; (ii) increasing control over the public wage bill (which represents about 13% of GDP and 60% of revenues), including by freezing new hires; (iii) increasing excises and strengthening tax administration; (iv) improving the efficiency of public expenditures; and (v) increasing the financial oversight over State Owned Enterprises (SOEs). The recapitalisation needs for the financial sector should also be properly budgeted in the law.

The **general government debt** remained at 44% of GDP in 2012, but it is projected to increase slightly to 45.3% of GDP by the end of this year and to peak at 49.5% of GDP in 2014. Debt service remains at a manageable 6% of total budget expenditures.

The rebound in growth throughout 2012 amid subdued world demand (particularly from the EU) and persistently high commodity prices contributed to a widening of the **current account deficit** to 8.1% of GDP (from 7.3% of GDP in 2011). The deficit has further increased in 2013, with the latest projections indicating a worsening to around 8.3% of GDP compared with the 7.5% of GDP targeted under the IMF programme. This is mainly explained by a drop in tourism revenues combined with a weaker demand for Tunisian goods, only partially compensated by lower than expected imports of capital goods and commodities (reflecting the slowdown in economic activity). Whereas in 2012 the increase in FDI inflows partially compensated for this effect, so far in 2013 FDI inflows have been about 40% below those initially assumed in the IMF programme. Moreover, disbursements of official assistance are well below what had been programmed.[2] As a result of these shortfalls in financing and the higher than programmed current account deficit, Tunisia faces a significant balance of payments gap (of around USD 750 million) for 2013 (see below). The IMF expects this shortfall to be covered by a decline of USD 600 million in foreign reserves compared to the original programme targets and by a further compression in public investment (which has high import content).

Foreign exchange reserves partially recovered to USD 8.6 billion (3.8 months of imports) in December 2012, compared to USD 7.5 billion (3.4 months of imports) at end-2011. However, in early 2013 they started declining rapidly, reflecting the worsening current account and FDI trends and heightened political instability, and this was one of the main reasons behind the authorities' decision to request an IMF SBA. By end-October 2013, reserves stood at USD 6.9 billion, covering only 104 days of imports. They are expected to finish 2013 at USD 7.5 billion, representing a decrease of USD 1.1 billion in 2013, which compares to an originally targeted increase of USD 400 million for the year.

The IMF has recently argued for more **exchange rate** flexibility in order to maintain external buffers and reduce liquidity injections. The modification, earlier in 2012, of the CBT's mode of foreign exchange intervention, and the setting of a reference rate quoted in the interbank market instead of a fixed currency basket, gave new flexibility to the exchange rate. The dinar has depreciated, in nominal effective terms, by around 12% since the revolution, and by around 6% since the beginning of 2013. This has partially adjusted the estimated moderate over-valuation of the currency to about 5%.

External debt increased from 48% of GDP in 2011 to an estimated 51% of GDP in 2013. In view of the prolonged political uncertainty and the longer-than-expected transition period, Tunisia's sovereign ratings were downgraded in October 2013 by Fitch (from BB+ to BB-),

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[2] This shortfall is largely due to the postponement of the issuance of Sukuk bonds originally planned for 2013, the decision by the World Bank to delay part of the DPL disbursements to 2014, and the decision by the African Development Bank to freeze plans on a potential loan on account of its excessive risk exposure to the MENA region.

following the downgrading by Standard & Poor's (from BB- to B) in August 2013 and by Moody's (from Baa3 to Ba1) in May 2013.

While **financial market indicators** have recently showed some signs of stabilisation, Tunisia's financial situation remains vulnerable, notably with regard to the banking sector. The 2011 crisis had a negative impact on a number of key banks, notably the public ones, which were more exposed to the hard-hit tourism sector. Non-performing loans were estimated at 17-18% at end-2012, and although capital adequacy ratios appear relatively sound (12.3%), they could prove inadequate because average bank provisioning (about 57%) is low. This led the CBT to provide substantial liquidity to the commercial banks during 2012 to help them cover their refinancing needs, although a gradual unwinding of liquidity injections has already been initiated. Under the programme agreed with the IMF, the authorities intend to proceed with the recapitalisation and rehabilitation of the banks affected by the crisis.

1.3. IMF and other donor support

On 7 June 2013, the **IMF** Board approved an USD 1.75 billion (400% of the Tunisian quota), two-year SBA. The authorities started considering the possibility of seeking financial support from the IMF already in mid-2012. The initial intention was to obtain a precautionary SBA with the Fund that would reassure stakeholders about the prospects of the economy, while minimising the political impact of the decision to have a programme with the Fund. However, the deterioration of the macroeconomic situation in 2013 (reflected in the increase in the budget deficit and the alarming downward trend of international reserves) and concerns about a possible shortfall in external financing urged the authorities to agree on a normal arrangement entailing the use of the Fund's resources. This opened the way also to a possible MFA from the EU.

The main objectives of the IMF programme are: i) to maintain macroeconomic stability, partly through the implementation of structural reforms and the selective recapitalisation of banks; ii) to support inclusive growth; iii) to reduce external vulnerabilities; and iv) to strengthen investor and donor confidence.

The SBA will run for 24 months from June 2013, with Fund resources available in nine instalments (approximately USD 650 million in 2013, USD 800 million in 2014 and USD 286 million in 2015). Quantitative performance criteria focus on fiscal, monetary and external objectives. They are complemented by indicative targets to monitor domestic arrears and preserve social spending. Structural benchmarks will focus on improving the efficiency of public expenditures (i.e.: reforming the price subsidy system), broadening the tax base and improving tax administration, strengthening the monetary policy framework, reducing banking system fragilities, and strengthening social safety nets.

The first review (measuring progress to June 2013) was supposed to take place in August 2013. However, given that the government, under pressure to resign and be replaced by a care-taker government until the next elections, felt unable to commit to forward-looking economic reforms, the IMF decided to carry out only a staff visit in September and to, postpone the first review until November. The first review is now expected to be merged with the second review and presented for Board approval in December, and this under the assumption that a new government will be able to commit to the reforms. The staff visit concluded that in addition to a worse than expected macroeconomic situation (including a significant overshooting of the fiscal targets), progress in the reforms established as structural benchmarks was lagging, and expected a number of waivers to be requested by authorities when the reviews take place.

The **World Bank** has made available USD 500 million in the form of a Development Policy Loan (DPL) in 2011 (as part of PAR I), a further USD 500 million in 2012 (as part of PAR II), and an additional USD 500 million also in the form of a DPL for 2013. However, in this last case the disbursement of half of the funds has been postponed to 2014.

The **African Development Bank** (AfDB), which has supported Tunisia with a number of policy based loans in the past (including its contributions to the PAR) and was expected to continue providing funding, has recently expressed reserves on account of excessive exposure to North Africa risk, and will not be signing a DPL worth USD 500 million that had been originally envisaged for 2013.

The **EBRD** Board agreed in October 2013 to grant Tunisia full country of operations status. It expects to sign up to EUR 85 million in loans in 2013, and at least EUR 40 million in 2014.

Since 2011, the **US** has provided over USD 350 million in economic support to Tunisia: USD 100 million in budget support; USD 30 million in guarantees (for a bond issuance of USD 458 million in 2012); and USD 220 million through credit lines, projects and technical assistance.

In 2012, **Japan** provided guarantees for the issuance of USD 303 million in Samurai bonds, and for a second issuance of USD 197 million in 2013.

Turkey approved a loan worth USD 200 million in June 2013 to fund priority projects in the infrastructure sector. In parallel, the Turkish Export Credit Line has extended a USD 200 million loan to Tunisia, partly aimed at funding the acquisition of Turkish equipment. Both loans carry concessional rates of 1.5%.

The **EU** has provided significant assistance other than the MFA under consideration. Overall support by the ENPI (European Neighbourhood & Partnership Instrument) has substantially increased since the revolution from around EUR 75 million to EUR 150 million in 2011, and will reach EUR 445 million over the period 2011-2013. Tunisia has been the first beneficiary of financial support from the SPRING Programme. An initial EUR 20 million allocation was made available in 2011, EUR 80 million in 2012, and EUR 55 million in 2013, bringing the total SPRING support to EUR 155 million for the period 2011-2013.

The bulk of the EU's assistance has been channelled in the form of budgetary support as part of the multi-donor aid packages known as ***Programme d'appui à la relance*** (PAR), which aimed at supporting reforms in the areas of employment creation, regional development, social action programmes, good governance and economic recovery. The successive PAR packages are considered a successful example of multi-donor coordination with a properly designed conditionality structure in response to the Arab Spring. **PAR I** (implemented in 2011) amounted to almost EUR 1.4 billion and, along with EUR 100 million from the EU, included contributions from the World Bank (USD 500 million), the AfDB (USD 500 million) and the *Agence Française du Développement* (AFD, EUR 100 million). It had a shared matrix of conditionalities for disbursement. **PAR II** (implemented in 2012) followed a similar structure, albeit with a lower volume of funds (EUR 1.1 billion); EUR 65 million from the EU, USD 500 million from the World Bank and a further USD 500 million from the AfDB. A **PAR III** is currently under preparation for 2013 and 2014. The EU is planning to contribute EUR 65 million (plus possible additional funds under SPRING) and the World

Bank USD 250 million. Additional commitments from the World Bank, AFD and AfDB may be forthcoming in 2014.

The **EIB** remains the largest external donor in Tunisia, where it has provided loans worth EUR 4.9 billion since 1979, around half a billion of which since 2011. In 2013, they expect to sign up to EUR 170 million in loans.

1.4. Tunisia's external financing needs

The revised projections that were produced following last September's IMF staff mission to Tunis point towards **significant balance of payments needs for the 2014-2015 period,** with the overall external financing gap estimated at **USD 4.4 billion** (USD 3.1 billion in 2014 and USD 1.3 billion in 2015; see Table 2).

This financing gap is broadly attributed to two factors; a persistently **large current account deficit** and the need to **build up foreign exchange reserves**. The IMF foresees that the current account deficit will gradually narrow, reflecting a sustained increase in exports driven by improved competitiveness and the recovery of global demand, but will remain sizeable (declining to 5.3% of GDP by 2015).

Despite its downward trend, the current account deficit is not expected to be covered by the surplus in the capital and financial account. Net FDI is expected to drop by about 50% in 2013 (less than USD 0.9 billion) compared to the previous year, before slowly picking up to USD 1 billion in 2014 and USD 1.4 billion in 2015, still 42% and 19% respectively below its 2012 levels (but in line with 2009-2010 levels).

Regarding official reserves, they are targeted to increase to USD 8.9 billion in 2014 and USD 9.9 billion in 2015, which will nevertheless only allow Tunisia to reach an import cover ratio of 3.8 months in 2015 (compared to 4.4 months in 2010).

The IMF's SBA and the World Bank's planned DPL would cover 31% of the projected external financing gap for 2014-15, which would still leave a **residual external financing gap** of USD 3.0 billion for the period.

For **2014**, the year when the financing needs are larger (USD 3.1 billion, before IMF and World Bank contributions), the main external financing sources are estimated to be the issuance by the government of USD 500 million of Sukuk bonds with a guarantee from the Islamic Development Bank, USD 300 million in US-guaranteed international bonds, and USD 300 million in Japanese-guaranteed Samurai bonds. EU budget support grants under the PAR are expected to amount to the equivalent of USD 86 million. The proposed MFA would contribute the equivalent of USD 221 million (EUR 170 million) this year in two tranches. An important assumption in the IMF programme for both 2014 and 2015 is that since domestic banks will have to be recapitalised in 2014 at an estimated cost of 2% of GDP, which will be done through non-negotiable bonds, this will crowd out other domestic financing of the government, obliging it to finance much of its deficit abroad.

For **2015**, although the financing needs are expected to be lower, they would still reach a sizeable USD 1.3 billion in a crucial year for the consolidation of many of the initiated reforms. The sources for the coverage of the gap in 2015 remain to be fully identified but are expected to include additional bilateral donor support as well as bond issuance. No new pledges have been made by the GCC countries, but this could change depending on the composition of the new government (discussions with Qatar are on-going for project grants worth USD 79 million). The proposed MFA would contribute USD 104 million (EUR 80 million) in 2015.

Thus, the proposed EU **MFA would contribute to cover some 10.8% of the residual financing gap** for the full 2014-2015 period.

Table 2: Tunisia's External Financing Gap and Potential Financing Sources (USD million)

(USD million)	2013	2014	2015	Total 2014-15
1. Current account balance*	**-3,537**	**-2,933**	**-2,588**	**-5,522**
2. Capital and financial account**	941	1,252	2,294	**3,547**
3. Overall balance (1+2)	-2,596	-1,681	-294	**-1,975**
4. Reserves ("-" indicates increase)	1,152	-1,418	-960	**-2,378**
5. Overall External Financing Gap (3+4)	**-1,444**	**-3,099**	**-1,254**	**-4,353**
6. Exceptional Financing by IMF and WB				
Net IMF Disbursements	659	800	286	**1,086**
Disbursements of World Bank's DPL	250	250	0	**250**
7. Residual Financing Gap (5+6)	**-545**	**-2,049**	**-968**	**-3,017**
Financing of the gap				
EU MFA (proposed)		*221*	*104*	*325*
EU budget support grants	91	130	65	**195**
Sukuk bonds (with IsDB guarantee)		500		**500**
US-backed international bonds		300		**300**
Samurai bonds (Japanese guaranteed)	197	300		**300**
Turkey bilateral	200			
Arab Monetary Fund	76	76		**76**
Unidentified	93	121		**121**
Total	**657**	**1,648**	**169**	**1,817**
Total MFA as % of the residual gap for 2014-15				**10.8**

* Excludes official grants provided in the form of policy-based budgetary support.

** Excludes official policy-based loans as well as planned issuance of international bonds. Figure for 2014 does not include potential additional USD 500 million DPL from the World Bank.

1.5. Structural reform challenges

Tunisia faces significant structural reform challenges. Despite a long period of economic growth and relatively prudent macroeconomic policies, which helped it record one of the highest per capita GDP growth rates among the Middle East and North Africa (MENA) oil importers, Tunisia continues to suffer from an excessive reliance on the development of an export-oriented, low-value added industry located near the coastline, to the detriment of other industries and the development of the interior. Also, a weak and inefficient banking sector and the pervasive use of capital controls and directed lending continue to constrain financial development and the allocation of saving to the most productive investments. Moreover, rigid labour markets and skill mismatches have contributed to high unemployment, particularly among the youth (averaging 30% in 2010), and participation rates (particularly among women) are very low, as it is the case in most countries in the region. Finally, transparency and economic governance are perceived as weak and the growth model has resulted in an unfair distribution of economic gains among the population.

Key reforms to meet these challenges include; reforming the costly and inefficient price subsidy system while strengthening the social safety net; reforming the taxation system and strengthen tax administration in order to increase tax collection, move to a more progressive tax system and better align the treatment of offshore and onshore industries; reforming the labour market; rehabilitating banks; and improving the trade and investment regime. Weaknesses in public finance management must also be addressed. However, many of these reforms generate strong resistance from vested interests, and will require time and effort to garner wide political and social support.

A key factor constraining the development of the Tunisian economy is the **dichotomy between the onshore and offshore sectors**, which has exacerbated regional disparities. The offshore sector is concentrated on the coastline and has benefitted from fiscal and regulatory incentives, whereas the onshore sector is in the (mostly less developed) interior, isolated from the rest of the economy and subjected to excessive tax and labour regulation. The zero-tax regime for offshore companies has attracted mostly assembly-type investments in low added value industries, with limited transfer of know-how and has resulted in a mismatch between high demand for low-quality labour and the supply of an educated workforce (producing high unemployment rates among graduates). Another factor constraining growth is the **lack of transparency, cronyism and complex regulatory procedures**, which lead to rent-seeking and anticompetitive behaviour, discouraging entrepreneurship and private investment. In order to address these problems, the authorities are committed to reforming **the investment code and corporate tax system** (thus enhancing the convergence between both sectors) and improving **competition legislation**.

As regards the **price subsidy system**, it is highly costly and regressive. Generalised subsidies should be replaced by cash transfer programmes targeted to the vulnerable parts of the population. Price subsidies on basic food, oil products, electricity and transport account for about 5% of GDP. The cost of energy subsidies alone tripled between 2008 and 2012 (from 0.9% of GDP on average before 2010 to 2.8% of GDP in 2012). However, the benefits of these energy subsidies accrue mostly to high-income households, which are estimated to benefit almost 40 times more than do the lower-income households. The authorities have already started addressing the issue, raising prices of electricity and gas by about 7-8% in March 2013, complementing a 7% increase implemented in September 2012, which is expected to generate savings of about 0.5% of GDP in 2013, and intend to introduce an automatic fuel pricing formula. In parallel, and as part of the IMF SBA benchmarks, the authorities are working with the World Bank to develop a household compensation strategy to pave the way for a more sustainable safety net system.

In the area of **tax reform,** in addition to the above-mentioned measures aimed at better harmonising the tax treatment of the offshore and onshore sectors, the authorities intend to strengthen the tax administration. This includes unifying the control and tax collection functions within a strengthened Large Taxpayer Unit, rationalising tax benefits/incentives in a revenue-neutral way and addressing the complexity of the indirect tax system (particularly excises). Authorities are also considering possible increases in excises and the VAT.

Another area where structural reforms will be needed is **public finance management** (PFM). PFM reform should concentrate on modernising the PFM system, increasing transparency and accountability and strengthening external and internal audit capacity. Also, the management of the investment budget suffers from very slow and sometimes arbitrary procedures to identify, select, and formulate projects. An updated Public Expenditure and Financial Accountability (PEFA) assessment is expected to be carried out in 2014 (the last one dates from 2010).

In the **financial sector**, a key challenge (addressed by the IMF programme) is to reduce vulnerabilities in the public banks. The country's three public banks represent 40% of total banking system assets, and they are hampered by weak lending practices, governance issues and an excessive exposure to a tourism sector that has been severely impacted since the revolution. The financing needs to recapitalise these public banks alone represent around 2.6% of GDP in the next two years. The CBT is addressing the shortcomings in banking supervision (by increasing onsite and credit risk inspections) and in data quality and provision (through a new data reporting system and the modernisation of the Public Credit Registry). It is also working to create a proper bank resolution mechanism. Finally, it is a tightening collateral requirement for banks' refinancing at the central bank, so as to reduce banks' dependence on CBT refinancing.

On **labour market reform**, the authorities signed a social contract in January 2013 with employers and trade unions, which should serve as a common social roadmap. The organisation of a permanent council for a tripartite social dialogue was agreed, as well as the establishment of an unemployment benefit fund. This should pave the way for the on-going discussions on the reform of the labour code, which are aimed at promoting greater flexibility and reduce the asymmetry of skills prevailing in the market. The successive donor-supported *Programmes d'appui à la relance* (PAR; see following section) have supported the implementation of employment programmes and strengthened coordination among labour-market intermediaries.

While Tunisia already has a relatively open **trade regime**,[3] it could benefit from further trade liberalisation. The preparatory process ("scoping exercise") for the launch of Deep and Comprehensive Free Trade Agreement (DCFTA) negotiations with the EU started in 2011, although discussions were interrupted in 2012 reflecting insufficient consensus within the governing coalition.

Many of the above-mentioned reforms are part of the policy programmes supported by the IMF, the World Bank and the EU through its budget support operations. The conditionality of the proposed MFA would complement and reinforce that of these operations.

2. OBJECTIVES AND RELATED INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE

2.1. Objectives

The objectives of the proposed MFA operation are to:

[3] Tunisia's average customs duty of 18% is in line when compared with other countries in the region (around 20%). Tunisia is a member of both the Great Arabic Free Trade Area (GAFTA) and the Agadir Agreement. It has signed a free trade agreement with Turkey and EFTA, which entered into force in July 2005. Tunisia has also signed a bilateral agreement with Libya, which entered into force in 2002.

- Contribute to covering the external financing needs of Tunisia in the context of a significant deterioration of the country's external accounts brought about by the on-going political and economic transition and developments in the region.

- Alleviate Tunisia's budgetary financing needs.

- Support the fiscal consolidation effort and external stabilisation in the context of the IMF programme.

- Facilitate and encourage efforts of the authorities of Tunisia to implement measures identified under the EU-Tunisia ENP Action Plan, while reinforcing the EU's economic policy dialogue with the authorities.

- Support structural reform efforts aimed at improving the overall macroeconomic management, strenghening economic governance and transparency, and improving conditions for sustainable growth.

2.2. Indicators

The fulfilment of the objectives of the assistance will be assessed by the Commission, including in the context of the ex-post evaluation (see below), on the basis of the following indicators:

- Progress with macroeconomic and financial stabilisation, notably by assessing the degree of adherence to the IMF-supported programme.

- Progress with the implementation of structural reforms, notably the specific policy actions identified as conditions for disbursement of the assistance, which will be included in a Memorandum of Understanding to be negotiated between the Commission and the Tunisian authorities. Conditions will include structural measures relevant for ensuring macroeconomic stability, e.g. measures in the field of public finance management reforms, fiscal reforms, as well as measures to support competitiveness and investment.

3. DELIVERY MECHANISMS AND RISK ASSESSMENT

3.1. Delivery mechanisms

The proposed new MFA would amount to EUR 250 million. Regarding the form of the assistance, the Commission proposes to disburse the full amount in the form of a medium-term loan.

The proposal, which is consistent with the methodology for determining the use of grants and loans in EU MFA endorsed by the Economic and Financial Committee in January 2011,[4] is based on the following considerations:

Firstly, Tunisia is a middle-income country with a **relatively high per capita income level**. Tunisia’s per capita Gross National Income (GNI) of USD 4,150 is above the average level of

[4]“Criteria for Determining the Use of Grants in EU Macro-Financial Assistance”, note of the European Commission to the EFC, January 2011.

the Southern partners covered by the ENP, representing the fifth highest per capita income in the region following Israel, Lebanon, Algeria and Jordan.[5]

Secondly, Tunisia's **public debt ratio** remains at a manageable level (44% of GDP at the end of 2012). While the ratio is expected to rise by almost 5 percentage points by 2015, it is projected to decline from 2015 onwards. Public external debt, for its part, is expected to peak at 34% of GDP in 2015, while total external debt should also peak in 2015 at about 55% of GDP.

Thirdly, Tunisia is **not eligible for concessional financing** from either the IDA or the IMF's Poverty Reduction and Growth Trust.

MFA is an untied and undesignated macroeconomic support instrument, which helps the beneficiary country meet its external financing needs, and may contribute to alleviating budgetary financing needs. The funds would be paid to the Central Bank of Tunisia. Subject to provisions to be agreed in the Memorandum of Understanding, including a confirmation of residual budgetary financing needs, the funds may be transferred to the Ministry of Finance of Tunisia as the final beneficiary.

3.2. Risk assessment

There are fiduciary, policy and political risks related to the proposed MFA operation.

There is a risk that the macro-financial assistance, which is not dedicated to specific expenses (contrary to project financing, for example), could be used in a fraudulent way. In general terms, this risk is related to factors such as the quality of management systems in the central bank and the ministry of finance, administrative procedures, control and oversight functions, the security of IT systems and the appropriatedness of internal and external audit capabilities.

To mitigate the risks of fraudulent use several measures will be taken. First, the Memorandum of Understanding and the Loan Agreement will comprise a set of provisions on inspection, fraud prevention, audits, and recovery of funds in case of fraud or corruption. Also, the assistance will be paid to a dedicated account at the Central Bank of Tunisia. Moreover, before the agreement on the Memorandum of Understanding is reached, the Commission services will conduct, with the support of external consultants, an Operational Assessment, in order to assess the reliability of financial circuits and administrative procedures that are relevant to this type of assistance and will determine whether the framework for sound financial management of macro-financial assistance is sufficiently effective in Tunisia. In the light of this assessment, specific mechanisms applying to the management of the funds by the beneficiaries may be introduced in agreement with the national authorities. The Commission is also using budget support assistance to help the Tunisian authorities improve their public finance management systems and these efforts are strongly supported by other other donors. Against this background, special conditionalities on improving public finance management will potentially be required. Finally, the assistance will be liable to verification, control and auditing procedures under the responsibility of the Commission, including the European Antifraud Office (OLAF), and the European Court of Auditors.

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[5] World Bank's Atlas 2011 figures. GNI per capita is the gross national income, converted to US dollars using the World Bank Atlas method, divided by the midyear population.

Another key risk to the operation stems from the regional security, economic and political uncertainties, notably in Libya, which have direct implications for the Tunisian economy. On the domestic front, significant uncertainties remain regarding the political transition process. The main risk is political instability and social unrest, which may lead to delays in the implementation of the economic and political reform process. A derailment of the adjustment process could put the objectives of the IMF-supported programme in jeopardy, endanger macroeconomic stability and prevent the effective disbursement of the MFA.

Finally, there are risks stemming from a possible weakening of the European and global economic environment (taking into account Tunisia’s high dependence on the EU market) and an increase in international energy and food prices, which would have an important effect on Tunisia’s fiscal consolidation efforts if the necessary reforms have not been put in place.

Having made a thorough assessment of the risks, the Commission services consider that there are sufficiently strong grounds to proceed with the MFA to Tunisia.

The Commission services will maintain close contacts with the authorities during the implementation of the macro-financial assistance in order to address quickly any concerns that may arise.

4. ADDED VALUE OF EU INVOLVEMENT

The Community financial support to Tunisia reflects the country's strategic importance to the EU in the context of the European Neighbourhood Policy. The instrument of macro-financial assistance is a policy-based instrument directed to alleviate short- and medium-term external financial needs. As a part of the overall EU package of assistance, it would contribute to support the European Union's objectives of economic stability and economic development in Tunisia. By helping the authorities' efforts to establish a stable macroeconomic framework, the proposed assistance would help improve the effectiveness of other EU financial assistance to the country, including budgetary support operations.

By helping the country overcome the economic difficulties caused by the political transition and the regional crisis, the proposed MFA will contribute to promote macroeconomic stability and political progress in the country. By complementing the resources made available by the international financial institutions, bilateral donors and other EU financial institutions, it contributes to the overall effectiveness of the package of financial support agreed by the international donor community in the aftermath of the crisis.

In addition to the financial impact of the MFA, the proposed programme will strengthen the government's reform commitment and its aspiration towards closer relations with the EU. This result will be achieved, inter alia, through appropriate conditionality for the disbursement of the assistance. In a larger context, the programme will signal to the other countries in the region that the EU is ready to support countries like Tunisia, embarking on a clear path towards political reforms, in moments of economic difficulties.

5. ESTABLISHED PRACTICE OF MACRO-FINANCIAL ASSISTANCE

The MFA proposal is consistent with the EU's commitment to support Tunisia's economic and political transition. It is also consistent with the wording of two MFA decisions on the Kyrgyz

Republic and Hashemite Kingdom of Jordan[6], which follow the Joint Declaration of the Parliament and the Council published together with the decision of the Parliament and the Council of 12 August 2013 providing further macro-financial assistance to Georgia. In particular, the Commission's proposal is consistent with the following principles: exceptional character, political preconditions, complementarity, conditionality and financial discipline.

5.1. Exceptional Character and Limited Timeframe

The proposed MFA operation will be exceptional and limited in time and will run in parallel to the IMF's Stand-By Arrangement (SBA). Against this background and given the expected time of approval of the programme, the assistance is expected to be implemented in 2014-2015. The disbursement of the first tranche could take place in the middle of 2014 provided that the IMF programs remains on track. The second and third tranches, conditional on a number of policy measures, agreed with the EU, could be disbursed in the fourth quarter of 2014 and first half of 2015, respectively. While in the short term the country faces substantial balance of payments financing needs, the macroeconomic and structural adjustment programme agreed with the IMF and supported by the proposed MFA is expected to produce a gradual strengthening of the balance of payments and fiscal positions.

5.2. Political preconditions and EU-Tunisia relations

MFA is reserved to geographically close third countries that respect democracy and human rights and with which the EU maintains close political and economic links.

Political preconditions: Countries that are covered by the ENP are eligible for MFA. A pre-condition for granting MFA should be that the eligible country respects effective democratic mechanisms, including a multi-party parliamentary system and the rule of law, and guarantees respect for human rights. Following the revolution and the ousting of President Ben Ali on 14 January 2011, Tunisia’s first free and democratic elections took place on 23 October 2011. A National Constituent Assembly has been in place since then. The political transition is proving difficult and the situation remains tense, following the murder of two prominent left-wing opposition politicians in the last year, which has delayed the finalisation of the Constitution, the setting up of independent electoral commission and the revision of the electoral law. However, a national dialogue is on-going to try to find a compromise on the different issues at stake, which should pave the way for the resumption of the work of the National Constituent Assembly and the organisation of elections in the first half of 2014.

EU-Tunisia relations: The EU seeks to develop a close relationship to Tunisia and to support Tunisia’s economic and political reforms. In 1995, Tunisia became the first country in the Southern Mediterranean to sign an Association Agreement with the EU. This agreement continues to be the legal basis for bilateral cooperation. Bilateral relations have been further reinforced under the EU’s ENP, including through the adoption of five-year ENP Action Plans establishing strategic objectives for this cooperation, the latest of which covers 2013-2017. Tunisia is also a member of the Union for the Mediterranean. Economic ties with the EU are important. Tunisia conducts the largest share of its trade with the EU. In 2012, the EU was the source of 59.3% of Tunisia’s imports and the destination of 68.1% of its exports. Tunisia has also a high dependence on the EU in terms of FDI and other financial flows, remittances and tourism inflows. Tunisia finalized the dismantling of tariffs for industrial

[6] Decision No 1025/2013/EU of 22 October 2013 providing macro-financial assistance to the Kyrgyz Republic; Draft Decision providing macro-financial assistance to the Hashemite Kingdome of Jordan, adoption of which is foreseen for December 2013.

products in 2008, thus becoming the first Mediterranean country to conclude a free trade agreement with the EU. The EU has offered Tunisia to negotiate a Deep and Comprehensive Free Trade Agreement with the goal to allowing the full access of Tunisia to the EU’s single market, although negotiations have not yet started.

Since the Arab Spring process began, the EU has declared on various occasions its commitment to support Tunisia in its economic and political reform process. The EU has doubled its financial support in the form of grants, making of it the largest recipient of funding under the SPRING Programme so far.

In sum, while Tunisia’s road to full democracy is not without difficulties and significant political, security, economic and social uncertainties remain, the country has taken significant steps towards political reform. In this context, the political preconditions for Macro-Financial Assistance may be considered to be sufficient but should be closely monitored before taking a final decision. A more detailed assessment of the compliance with this criterion, provided by the European External Action Service (EEAS), is reproduced in the Annex of this Staff Working Document. Compliance with these criteria will continue to be monitored by the Commission in liaison with EEAS throughout the life of the MFA operation.

5.3. Complementarity

The proposed MFA would complement the assistance provided by other multilateral and bilateral donors in the context of the IMF-sponsored economic programme. The total financing already identified to be provided by donors other than the EU would amount to USD 1.4 billion for the period 2014-15, representing 31% of the overall external financing gap, ensuring fair burden sharing between the EU and other donors. The EU MFA would also complement the standard EU aid packages mobilised under the ENPI and the SPRING Programme, and in particular the conditionalities envisaged under the budget support PAR III package. Close coordination will be ensured in the implementation of these two programmes. Both programmes are complementary and mutually reinforcing. While the envisaged MFA will provide short term balance of payments support the state building contract will support the completion of the democratic transition process through economic and political governance measures. By supporting the adoption by the Tunisian authorities of an appropriate framework for macroeconomic policy and structural reforms, the EU’s MFA would enhance the added value and effectiveness of the EU's involvement through other financial instruments.

5.4. Conditionality

The disbursements would be conditional on successful programme reviews under the IMF programme and on the effective use by Tunisia of these IMF funds. In addition, the European Commission and the Tunisian authorities would agree on a specific set of structural reform measures, to be defined in a Memorandum of Understanding. These reform measures will support the authorities’ reform agenda and complement the programmes agreed with the IMF, the World Bank and other donors, as well as the policy programmes associated with the EU’s budgetary support operations.

The European Commission will seek a broad consensus with the Tunisian authorities, so as to ensure a smooth implementation of the agreed conditionality. These policy conditions should address some of the fundamental weaknesses accumulated over the years by the Tunisian economy. Possible areas of conditionality could in principle include: public finance management; fiscal reforms to increase tax collection and improve the progressivity of the tax system; reforms to strengthen the social safety net; labour market reforms (to reduce unemployment and raise participation rates, notably among women); financial sector reforms; and measures to improve the regulatory framework for trade and investment.

5.5. Financial Discipline

The planned assistance would be provided in the form of a loan and should be financed through the borrowing operation that the Commission will conduct on behalf of the EU. The budgetary costs of the assistance will correspond to the provisioning, at a rate of 9%, of the amounts disbursed in the guarantee fund for external lending of the EU, from budget line 01 04 01 14 ("the provisioning of the Guarantee Fund"). Assuming that the first and second loan disbursements will be made in 2014 for the amount of EUR 170 million (EUR 90 million and EUR 80 million, respectively) and the third loan disbursement in 2015 for the amount of EUR 80 million and according to the rules governing the guarantee fund mechanism, the provisioning will take place in the 2016-17 budgets.

To ascertain that the beneficiary has in place a sound financial management in line with the requirements of the Financial Regulation, the European Commission services will undertake an Operational Assessment that should provide an updated report on the reliability of the financial circuits and administrative controls at the Ministry of Finance and the Central Bank of Tunisia, while considering the results of the Public Finance and Financial Accountability (PEFA) assessment of Tunisia conducted in 2010 with EU funding, and the regular reports on progress with PFM reform produced by the EU Delegation in Tunis.

6. PLANNING OF FUTURE MONITORING AND EVALUATION

This assistance is of exceptional and macroeconomic nature and its monitoring and evaluation will be undertaken in line with the standard Commission procedures.

6.1. Monitoring

Monitoring will involve the review of reports and data provided by the authorities and by review missions to Tunisia by Commission staff. To monitor the fulfilment of the objectives of the programme throughout the implementation period of the assistance, the Commission will use two types of indicators:

- Adherence to the IMF-supported programme, including compliance with macroeconomic performance criteria and structural reform benchmarks identified under the SBA, as reported by the IMF in the context of the regular review of the programme.

- Progress in the implementation of structural policy indicators, which are to be agreed with the Tunisian authorities in a Memorandum of Understanding. In this process, the Commission services will monitor key areas of the public finance management system, as they will be identified in the update of the Operational Assessment, so as to have the relevant information on any changes in the control environment. Ahead of the disbursement of the second and third instalments, the authorities will be asked to submit a compliance statement in relation to the policy conditionalities. In addition, under the Memorandum of Understanding monitoring system, the authorities will be required to submit quarterly reports of certain economic and reform indicators.

Although this assistance is centrally managed, where appropriate, the EU Delegation in Tunisia will also be called to provide reporting. An annual report, as well as regular information on developments in the management of the assistance, to the European Parliament and to the Council are foreseen.

6.2. Evaluation

Ex-post evaluations of macro-financial assistance operations are foreseen in the Multi-Annual Evaluation Programme of the Commission's Directorate-General for Economic and Financial Affairs. An ex-post evaluation of the proposed macro-financial assistance to Tunisia will be launched within a period of two years after the completion of the operation. A provision for the ex-post evaluation is included in the proposed Decision for the assistance, and will also be included in the Memorandum of Understanding. Budget appropriations from the macroeconomic assistance budget line will be used for this evaluation.

7. ACHIEVING COST-EFFECTIVENESS

The proposed assistance would entail a high degree of cost effectiveness for several reasons:

- First, since the assistance would be leveraged by that provided by the international financial institutions, with which, as noted, it would be closely coordinated, its ultimate impact could be very significant compared to its cost. Moreover, in negotiating specific policy conditions, the Commission will be able to draw on the expertise of those institutions, including the International Monetary Fund and the World Bank, and to influence their conditionality as well in ways that will take into account the EU's views.

- Second, providing a coordinated macroeconomic support to Tunisia on behalf of the EU countries, the MFA would be more cost efficient than the provision of a similar total amount of financial support by EU Member States individually.

- Third, all of the assistance would be provided in the form of loans, the budgetary impact of which is more limited.

- In addition, the Commission will aim at achieving synergies with other EU policies and instruments used to support the implementation by the beneficiary of the relevant measures (notably in the area of public finance management).

ANNEX

EUROPEAN EXTERNAL ACTION SERVICE

DIRECTORATE North Africa, Middle East, Arabian Peninsula, Iran and Iraq
DIVISION Maghreb

Brussels, 9 November 2013

ASSESSMENT ON TUNISIAN POLITICAL REFORMS

A tense political situation

Following the revolution and the ousting of Ben Ali on 14 January 2011, President ad-interim Mr M'bazaa governed by decree. As from March, a transitional government led by Mr. Caïb Essebsi managed to prepare Tunisia's first democratic elections on 23 October 2011. Overall participation in the elections was 54,1% of the registered voters. A National Constituent Assembly (ANC) has been in place since then. The EU Electoral Observation Mission said elections were overall organised in a satisfactory manner. It praised the efforts of the national supervision committee (ISIE) in the organisation of the elections given the timelines. Electoral campaign was rather limited but the media, especially public owned audio-visual sector, plaid a key role and ensured an equality of treatment among candidates' lists.

Elections were won by Ennahda (Islamists), followed by two centre-left parties: *Congrès pour la République (CPR)* and Ettakatol. According to a tripartite agreement among them ("Troïka"), Mr Marzouki (CPR leader) was elected President of the Republic. Ennahda's Secretary General, Mr Jebali was appointed Prime Minister while Mr Ben Jafaar (leader of Ettakatol) was elected President of the ANC.

Since, most of the initial opposition parties have been recomposed. Former PM Caïb Essebsi founded a new major secular opposition party, Nidaa Tounes. Al Joumhouri ("republican party"), democratic Alliance and Wafa were created. Initially there were 8 independent MPs in the ANC, currently there are 31 (mostly defections from *Popular petition*, CPR, Ettakatol).

On 24/12/2011, the Ennahda-led transition government took up office with the task of managing the country until the new Constitution is adopted and new elections take place. Despite a large political consensus on the duration of the ANC - one year - no limit has been formally fixed. This has been criticised by the opposition and by several civil society organisations.

Since the summer of 2012 there have been growing political tensions, insecurity and political violence, carried out in particular by extremist groups, including the "Committees for the defence of the revolution" (CDR). Among other events: the attack on the USA Embassy, the death of Nida Tounes' representative in Tataouine, recurring clashes between security forces and "salafist" militants, violent attack by CDR against UGTT (main Trade Union organisation).

As a result of these events, the government and Ennahda in particular, were accused of being unable to address or to mitigate this violence, and of being politically responsible for it. Foreign partners requested action to reinforce rule of law and security.

Polarisation between the "Troika" and the secular opposition coalesced around Nidaa Tounes has increased. As a result the dominant position of Ennahda is increasingly challenged.

Tensions culminated in the murder of left wing opponent Mr Belaid on 6 Feb. 2013 and the consequent resignation of PM Jebali and his government. On 22 February, President Marzouki appointed a new Ennadha PM, Mr Larayedh (Minister of Interior in the previous Government). Although composed by the same Troika parties, several key ministries were attributed to independent personalities, including the Interior.

Challenges for in 2013: following a further political assassination; that of Mr. Brahmi (left wing opposition MP) on 25 July 2013, massive public protests against the government took place and the ANC President decided to temporarily suspend proceedings. This resulted in further delays in the political process (finalisation of the constitution, setting up of an independent elections commission, revision of the electoral law, etc.), increasing political polarisation between secular and islamist forces (also following events in Egypt during the summer) amidst a number of worrying security incidents at the borders with Algeria and in the Chaambi mountains, social unrest and high unemployment.

A "national dialogue", initiated by a "Quartet" composed of the UGTT, UTICA (representing businessmen), the Unions of lawyers (Ordre national des avocats) and the Tunisian ligue for protection of human rights was initiated in August and formally launched on 26 October 2013 to find a compromise on the different issues at stake. A "road map" with very tight deadlines until end November 2013 has been agreed: appointing a new Prime Minister by 02/11 at the latest, appointing a new government of technocrats / independents and adopting the new Constitution end of November with a view to preparing new democratic elections in 2014.

New serious security incidents have contributed to cast a shadow on this process: about ten members of the national security forces and equivalent number of supposed "terrorists" have been killed in different parts of Tunisia (North West, Centre), followed by two attempted terrorist attacks in Sousse and Monastir on 30 October.

To date the different parties involved in this dialogue have not overcome their divergent views on choosing a new head of government. In this context, it is difficult to predict the final outcome of the political dialogue, although the adoption of the new Constitution may still take place by the end of 2013 and next elections could be organised in 2014.

EU-Tunisia relations

Relations progressed more slowly than expected: however a political agreement on the Action Plan was reached at the EU-Tunisia Association Council in November 2012 as part of a “privileged partnership”. The formal adoption of the Plan depends on the finalisation of the matrix on 'priority actions', which could take place within next months.

The decision by EU Member States to actually launch the negotiations on the Deep and Comprehensive Free Trade Agreement (DCFTA) is conditional on a positive conclusion of the on-going "scoping exercise", i.e. assessment missions by DG Trade. Two missions took place in April and October 2012, and a third and final scoping meeting should be organised by end 2013.

On the Agreements on accreditation and acceptance of industrial products (ACAA), the negotiations, are still expected to be initiated shortly.

On the Air Services Agreement (Open Sky) to liberalise air transport, concrete negotiations started in late June 2013. A second round is also expected to take place.

Agricultural negotiations were well advanced in November 2010. They should in principle be resumed although Tunisian authorities have recently showed some reluctance to move forward.

Finally, it is worth noting that a dialogue on a mobility partnership (migration issues) between the EU and Tunisia was re-activated in the summer 2013. A new round of negotiations should take place mid-November in Tunis.

In sum, while a number of major political, security, economic and social challenges remain, the EU is committed to support Tunisia in its transition process. In this context, the political preconditions for Macro-Financial Assistance may be considered to be sufficient but should be closely monitored before taking a final decision.