Report Number : ICRR12865

IEG ICR Review
Independent Evaluation Group

1. Project Data:		Date Posted :	04/17/2008	
PROJ ID :	P075893		Appraisal	Actual
Project Name :	Tn - Ecal Iv	Project Costs (US$M):	150	149.2
Country:	Tunisia	Loan/Credit (US$M):	150	149.2
Sector Board :	FSP	Cofinancing (US$M):		
Sector(s):	Banking (25%) General industry and trade sector (25%) Non-compulsory pensions insurance and contractual savings (20%) Central government administration (20%) Capital markets (10%)			
Theme(s):	Regulation and competition policy (29% - P) Other financial and private sector development (29% - P) Macroeconomic management (14% - S) Debt management and fiscal sustainability (14% - S) State enterprise/bank restructuring and privatization (14% - S)			
L/C Number:	L7304			
		Board Approval Date :		06/09/2005
Partners involved :	African Development Bank, European Union	Closing Date :	06/30/2005	06/30/2005

Evaluator:	Panel Reviewer :	Group Manager :	Group:
Elliott Hurwitz	Konstantin Atanesyan	Ali Khadr	IEGCR

2. Project Objectives and Components:

a. Objectives:

(1) Maintaining a sound and reactive macroeconomic framework, in particular by promoting fiscal consolidation and strengthening the medium term fiscal framework
(2) Improving Tunisia's private investment climate and increasing private investment opportunities
(3) Reinforcing the financial sector's capacity to finance growth, by :

- supporting initiatives to reduce the level of non-performing loans;
- further strengthening the regulatory framework for bank intermediation; and

- fostering development of contractual savings, especially in the insurance sector

b.Were the project objectives/key associated outcome targets revised during implementation?

No

c. Components (or Key Conditions in the case of DPLs, as appropriate):

Components included: Private Investment--Further reduce required administrative authorizations for investment; alleviate financial conditions to create a company, e .g., minimum required capital; extend to additional companies existing accelerated VAT reimbursement; improve relations between corporate tax -payers and tax authorities; set Competition Council as legal authority and strengthen its authority; improve tax environment for investment by harmonizing incentives between current exporters and potential exporters . Banking Sector: Increase provisioning, loan write-offs, and transfers of NPLs. Insurance Sector: Enhance autonomy of insurance supervisor; take further steps to restructure state-owned insurance firms; complete restructuring of automobile insurance sector . Securities Markets: Reduce relative cost of transparency for listed firms; prepare Financial Security law; prepare ethics code for brokers. Macroeconomic Framework: Achieve fiscal consolidation goals; strengthen budget management; enhance public debt management.

Conditions necessary for disbursement were: First Tranche–(1) Modify budget law to require increase in advanced VAT reimbursement from 1 percent to 25 percent. (2) Submit to Chamber of Deputies (CD) draft law: amending Competition Law to increase autonomy of Competition Council (CC); requiring prior consultation of CC for all actions impacting competition; increasing ability of CC to initiate cases; certification by Central Bank (CB) that capital adequacy ratio of commercial banks with provisioning gap is not below regulatory limits . (3) Publish circular increasing auto insurance civil responsibility by 5 percent. (4) Achieve designated macro indicators. Second Tranche–(1) Enact laws reducing required prior authorizations for private investors . (2) Insert in 2006 draft budget increase of advanced VAT reimbursement rate; if approved by study, submit to CD draft law to increase VAT repayment. (3) Certification by CB that commercial banks with provisioning gap used full earnings and part of reserves to fully eliminate this gap and maintain capital adequacy ratio below regulations . (4) Communicate results of annual review of change in NPLs; adoption by CB of prudential regulations for credits to firms not complying with transparency requirements. (5) Submission to CD draft law modifying statute of Insurance Supervisor . (6) Submission to CD draft law eliminating restriction on foreign investors' majority participation in insurance firm capital. (7) Submission to CD draft law to: create independent audit committees in firm Boards; certification by managers on compliance of financial statements with regulations; other provisions . (8) Achieve designated macro indicators. (9) Promulgate 2007/07 fiscal framework, satisfactory to Bank, that envisions positive primary fiscal balance .

d. Comments on Project Cost, Financing, Borrower Contribution, and Dates:

The first tranche disbursement of US$75 million (EUR 58.6 million) was made on September 20, 2005, immediately after project approval. A second tranche disbursement of US$74.2 (EUR57.5 million) was made on June 18, 2007. The loan was prepared in partnership and disbursed in parallel with the African Development Bank, which made a loan of EUR117 million, and the European Union, which provided a grant of EUR 78 million.

3. Relevance of Objectives & Design:

The project was the fourth in a series with similar objectives. The objectives overall were *substantially* relevant. They delineated areas where the dialogue with the Bank had been active, and in which progress could make a major contribution to the country's overall economic growth and improvement in employment .

The design capably addressed most areas delineated by the objectives . In particular, the measures undertaken by the project in the areas of improving the private investment climate, increasing private investment opportunities, and strengthening the capacity of the financial sector capably addressed effective progress in these areas .

4. Achievement of Objectives (Efficacy):

(1) *Maintaining a sound and reactive macroeconomic framework, in particular by promoting fiscal consolidation and strengthening the medium term fiscal framework.*

Overall achievement of this objective was *moderately satisfactory*. Macroeconomic performance was good, assessed by the IMF to be "among the best in the region" over the last decade (IMF Article IV Consultation, 8/07, p. 3). As shown in Table 1 below, real GDP growth increased to 5.4 percent in 2006 and 6.0 percent 2007 after declining to 4 percent in 2005. The acceleration was due to strong performance in agricultural output, expansion of nontextile manufacturing, and growth in the services sector. Monetary policy was tightened, and fiscal policy lead to a reduction of the ratio of government debt to GDP. However, the unemployment rate did not significantly improve, even though it was a high priority for the Government, calling for increasing GDP growth to 6.5 percent as well as for

much higher levels of private investment.

Table 1: Selected Macroeconomic Indicators

	2003	2004	2005	2006 est.	2007 proj.
Real GDP growth (%)	5.6	6.0	4.0	5.4	6.0
Total government debt*	60.5	59.4	58.3	54.1	53.1
Gross private investment*	13.5	13.0	12.8	13.3	***
Current Account Balance*	-2.9	-2.0	-1.1	-2.6	-2.7
Unemployment rate (%)	14.3	14.2	14.2	14.2	14.1

Source: World Bank, CAS Progress Report, 08/07, p. 2. World Bank Economic Monitoring Report, 4/08, p. 10; IMF Article IV Consultation 11/04, p. 28.
* Percent of GDP

As regards to fiscal consolidation and debt management, the IMF Staff Appraisal of the 2007 Article IV Consultation states that "fiscal policy has been prudent but further fiscal consolidation is necessary to maintain long -term fiscal sustainability, in view of growing budget pressures, particularly from population aging and declining nontax and tariff receipts." As can be seen in Table 2, the Government has succeeded in maintaining the overall fiscal position stable in spite of the surge in oil prices in world markets, a increasingly heavy social security burden, and the impact of terrorism.

Table 2: Fiscal Policy Indicators

	2003	2004	2005	2006	2007 proj.
Total revenue*	23.7	23.9	23.6	23.8	22.9
Total expenditure*	26.7	26.8	26.8	26.4	25.8
Central gov't deficit, excluding grants/privatization*	-3.5	-2.9	-3.2	-2.9	-2.9

Source: IMF Article IV Consultations: 8/07, p. 22, 24; 6/06, p.22; 11/04, p.31, 35;
* Percent of GDP

The goal on strengthening the medium term fiscal framework was achieved, albeit later than expected, due to exogenous factors. ECAL IV foresaw the introduction of a medium-term fiscal framework (2007/09) satisfactory to the Bank, with a positive primary fiscal balance as of 2008. However, the first MTEF prepared by the Government assumed a world oil price of US$45/barrel, which turned out to be well below what happened. A new MTEF prepared in May 2007 delayed potential attainment of a positive fiscal balance until 2009 (ICR, p.7). As the IMF states in its 2007 Article IV Consultation, "fuel subsidies continue to weigh heavily on the budget, despite the cumulative price increase of 51 percent since 2005. The authorities are aware of their inefficiencies and intend to gradually phase them out, however they have not yet specified a date for their removal." An additional factor contributing to the fiscal imbalance was the social security system. In this regard, the IMF stated: "the financial position of the social security system has steadily worsened since the end of the 1990s, reflecting population aging. The social security system moved from a surplus of 1.3 percent of GDP in 1999 to a 0.3 percent deficit in 2006."

(2) Improving Tunisia's private investment climate and increasing private investment opportunities.

Achievement of this objective was *moderately unsatisfactory*. As stated in the ICR, the number of private investment opportunities increased, and the number of administrative authorizations for private investment and the delays in granting authorizations have been reduced. The number of import restrictions was also reduced. Finally. measures were implemented to reimburse VAT taxes more quickly to those doing international business, which would encourage those in this area. Focusing on progress in terms of changes of laws on the books, Tunisia's rank in the World Bank's "Doing Business" indicators improved slightly from 2007 to 2008, rising from 93rd to 88th of the 178 countries and cities rated, ranking highly in Closing a Business (30th) and Trading Across Borders (28th), but less well in Employing Workers (113th), Protecting Investors (147th), and Paying Taxes (148th).

Focusing on development on the ground, the PDO indicator used to track progress in this component was the evolution of investment by on-shore and off-shore companies, which were reported in the ICR datasheet as follows:

Investment Growth 2004-2007	On-shore investment	Off-shore investment
Target Value	+ 9.7%	+37.9%
Actual Value achieved	+6.1%	+17.7%

In addition, as shown in Table 3, below, Foreign Direct Investment (FDI) fluctuated considerably from 2002 to 2007. The large increase in 2006 reflects US$2.35 billion received from the partial privatization of Tunisie Télécom. Around two thirds of overall 2007 FDI went to the energy sector, with smaller amounts going to manufacturing, services, and tourism.

Table 3: Trends in Investment and Lending

	2002	2003	2004	2005	2006	2007 proj.
Net Private FDI*	801	553	616	812	2,780	1,100
Long-term loans (net)*	766	823	977	297	6	340
Official loans*	272	278	184	62	229	56
Private loans*	494	545	793	236	-224	284

Source: World Bank, CAS Progress Report, 08/07, p. 31; World Bank Economic Monitoring Report, 4/08, p. 10.
* US$ million

(3) Reinforcing the financial sector's capacity to finance growth, by : supporting initiatives to reduce the level of non-performing loans; further strengthening the regulatory framework for bank intermediation; and fostering development of contractual savings, especially in the insurance sector .

Achievement of this objective was *moderately satisfactory.*

The first component was to support initiatives to reduce the levels of non-performing loans (NPLs). Table 4 includes the most recent information on key variables of the financial system . The ratio of NPLs to gross assets peaked at 24 percent in 2003, following the impact of terrorist activities on the tourism industry . Subsequent actions have helped bring the ratio down gradually back 19.2 percent, the level where it was in 2001. ECAL IV has been instrumental in the reduction by 1.7 percentage points in the ratio. Nevertheless, the most recently reported levels remains an area of concern, an issue that was highlighted in the IMF Staff Report of the Article IV Consutlation of 2007.

Table 4: Banking System Indicators

	2001	2002	2003	2004	2005	2006*
Capital adequacy ratio	10.6	9.8	9.3	11.6	12.4	11.8
NPLs (percent of gross assets)	19.2	20.9	24.0	23.7	20.9	19.2
Provisions (percent of NPLs)	47.4	43.9	43.1	45.8	47.4	49.2
Return on assets	1.1	0.7	0.6	0.4	0.5	0.2
Return on equity	14.0	8.0	7.6	5.1	6.5	9.1

Source: IMF Article IV Consultations, 8/07, p. 13.
* Preliminary

The second component was to strengthen the regulatory framework for financial intermediation. Key among the changes was bolstering the solvency of the system by gradually increasing the provisioning ratio, helping in NPL workouts including by eliminating the legal and tax obstacles that made them difficult . The provisioning ratio gradually increased in recent years, as did the capital adequacy ratio . While the return on assets has declined in the process, the return on equity in the system is increasing once again . The program also was instrumental in improving the capacity of the banking regulator.

The third component was to foster the development of contractual savings, especially in the insurance sector . In this regard, The role of the insurance supervisor was strengthened, restrictions on the participation of foreign investors in insurance companies were reduced, and the flexibility of companies to raise regulated insurance rates was granted . In addition, a new law was passed that increased the mandate of the securities market regulator, and enhanced the transparency of the market. Available data show that, overall, development of life insurance was positive . Sales turnover of life insurance rose 44% from 2005 to mid-2007, while the capital of insurance companies rose 28% during the same interval. The number of life insurance contracts subscribed, however, fell by 31% over that period. By project completion, no baseline data were available for the use of PDO Indicator 5, that was to have assessed the number and amount of new life insurance contracts. The lack of baseline data was due, in large measure, to the hesitancy of the Borrower to set targets, and the unavailability of pertinent data .

PDO Indicators: As reported on the ICR Datasheet, the project utilized 5 indicators reflecting PDO achievement. As

reported, 1 of the 5 was achieved, 2 were not achieved, and 2 were not assigned target values. The lack of baseline and recent data on the indicators is very disappointing.

5. Efficiency (not applicable to DPLs):

N/A

a. If available, enter the Economic Rate of Return (ERR)/Financial Rate of Return (FRR) at appraisal and the re-estimated value at evaluation :

	Rate Available?	Point Value	Coverage/Scope*
Appraisal	No		
ICR estimate	No		

* Refers to percent of total project cost for which ERR/FRR was calculated.

6. Outcome:

Although the overall relevance of the project objectives was *substantial*, the degree to which they were achieved was moderately satisfactory. Little or no data was presented in the ICR on the institutional achievements of the project. Overall, the project is rated moderately satisfactory in achieving its major relevant objectives.

a. Outcome Rating : Moderately Satisfactory

7. Rationale for Risk to Development Outcome Rating:

The risk that the modest development outcomes--that were achieved--will not be maintained is low because the reforms supported by the project are already in place.

a. Risk to Development Outcome Rating : Negligible to Low

8. Assessment of Bank Performance:

The design of the project was overall satisfactory, with most components accurately targeted at economic variables critical to the country's growth and which will have an important contribution to welfare. However, the selection of indicators that meaningfully reflected successful progress was substantially deficient, and for 2 of those 5 indicators selected no baseline data were established.

a. Ensuring Quality -at-Entry: Satisfactory

b. Quality of Supervision : Satisfactory

c. Overall Bank Performance : Satisfactory

9. Assessment of Borrower Performance:

As far as can be determined, the Borrower complied with most project requirements. Borrower performance was adequate to allow the approval of the second tranche of the project in June, 2007.

a. Government Performance : Satisfactory

b. Implementing Agency Performance : Satisfactory

c. Overall Borrower Performance : Satisfactory

10. M&E Design, Implementation, & Utilization:

Project Monitoring and Evaluation is assessed to be modest. Deficiencies include:

- Inadequate data to assess project progress in achieving objectives that include institutional improvement and enhanced capacity.
- Inadequate baseline data to assess the benefits (e.g., increased domestic finance, additional funds for social safety nets) that were linked to the increased capacity in several areas.
- Inadequate data to evaluate the economic effects of actions taken (e.g., employment, bank lending, bank

soundness).
As far as can be determined, this information was not collected to inform decision -making with respect to the project, and revise (if appropriate) the allocation of resources as part of project supervision .

a. M&E Quality Rating : Modest

11. Other Issues (Safeguards, Fiduciary, Unintended Positive and Negative Impacts):

12. Ratings:	ICR	IEG Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	Outcome is judged moderately satisfactory in two of the three objectives. The third objective regarding fostering investment has yet to show a noticeable impact.
Risk to Development Outcome:	Negligible to Low	Negligible to Low	
Bank Performance :	Satisfactory	Satisfactory	
Borrower Performance :	Satisfactory	Satisfactory	
Quality of ICR :		Unsatisfactory	

NOTES:
- When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
- The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate .

13. Lessons:

As part of the project design, a comprehensive series of indicators should be developed that effectively reflects progress in each area of project activity .

- For a project such as EC DPL IV, where the benefits of the actions taken are well -defined, information should be thoroughly collected regarding the trends in these areas before, during, and after the project .

14. Assessment Recommended? ● Yes ○ No

Why? A thorough assessment should be undertaken of : (1) whether the intended actions to strengthen institutional capacity were achieved; (2) whether the expected economic impacts were achieved .

15. Comments on Quality of ICR:

The ICR is *unsatisfactory*. The evaluation presents inadequate substantiation for the stated achievements . The evidence relating to institutional strengthening is modest, for example, regarding fiscal consolidation and debt management. Inadequate information is presented on the success in the key functions involved in improving public debt management (PD, para. 44, p. 15): setting up a "middle office" in the Ministry of Finance, presentation of an action plan to consolidate debt management functions, and other specific actions relat ed to debt management.

The ICR presents limited macroeconomic data in the narrative, but does not provide a comprehensive statement of macroeconomic progress. It also does not present important and pertinent information from the August, 2007, CAS Progress Report, or from other sources including the IMF --which was a partner in some activity under the project. As shown above in Table 3, the IMF provided comprehensive information on bank soundness that is important to PDO 3.

In the section on Quality of Supervision, the ICR states : "The rating of satisfactory is based on the following considerations: (i) the project was very well designed, its PDO in line with the Country's and the Bank's priorities, the indicators were relevant even if some of the data was not collected before the close of the project ." This statement is not valid when there was an insufficient number of indicators, when important variables were not addressed, and when 2 of the 5 variables did not have baseline data.

The ICR also states that PDO Indicator 3 was met, however, data in the ICR datasheet indicate that it was not met. The ICR states that the project was "satisfactory" when only 1 of 5 PDO Indictors can be viewed as having been achieved, and 5 of 15 Intermediate Outcome Indicators were met.

a.Quality of ICR Rating : Unsatisfactory