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Report No.106348-TN

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

FOR A PROPOSED LOAN

IN THE AMOUNT OF EURO 457.2 MILLION

(EQUIVALENT TO US$500 MILLION)

TO THE

REPUBLIC OF TUNISIA

FOR THE

# BUSINESS ENVIRONMENT AND ENTREPRENEURSHIP DEVELOPMENT POLICY LOAN

May 9, 2017

Macroeconomics and Fiscal Management Global Practice
Trade and Competitiveness Global Practice
Finance and Markets Global Practice
Middle East and North Africa Region

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# REPUBLIC OF TUNISIA

**GOVERNMENT FISCAL YEAR**
January, 1 – December 31

**CURRENCY EQUIVALENTS**
(Exchange Rate Effective as of *April 30, 2017*)

US$1 = Euro 0.91424392

## ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| AFD | French Agency of Development, "*Agence Francaise de Developpement"* |
| ATIC | Tunisian Association of Capital Investors |
| BEE | Business Environment and Entrepreneurship |
| BH | Housing Bank, *Banque de l'Habitat* |
| BIS | Basic Investment Statistics |
| BTS | Tunisian Bank for Solidarity, *Banque Tunisienne de Solidarite* |
| BFPME | Small and Medium Enterprises Bank, *Banque de Financement des Petites et Moyennes Entreprises* |
| CDC | Fund for Deposit and Consignment, *Caisse de Depots et Consignation* |
| CBs | Credit Bureaus |
| CNAM | National Health Insurance Fund, *Caisse Nationale d'Assurance Maladie* |
| CPF | Country Partnership Framework |
| CNRPS | National Pension and Social Welfare Fund, *Caisse Nationale de Retraite et de Prevoyance Sociale* |
| CNSS | National Social Security Fund, *Caisse Nationale de Securite Sociale* |
| CSEE | Business Monitoring Commission (Ministry of Industry and Commerce), *Commission de Suivi des Entreprises* |
| DPL | Development Policy Loan |
| DPR | Development Policy Review |
| DLIs | Disbursement-Linked Indicators |
| DSA | Debt Sustainability Analysis |
| EIA | Environmental Impact Assessment |
| EFF | Extended Fund Facility |
| FDI | Foreign Direct Investment |
| FOPROLOS | Social Housing Promotion Fund, *Fonds pour la Promotion du Logement Social* |
| FX | Foreign Exchange |
| GDP | Gross Domestic Product |
| GOJ | Governance Opportunities and Jobs |
| GoT | Government of Tunisia |
| GRS | Grievance Redress Service |
| IBP | Integrated Bank of projects |
| IBRD | International Bank for Reconstruction and Development |
| IFC | International Finance Corporation |
| ILO | International Labor Organization |
| IMF | International Monetary Fund |
| KfW | Kreditanstalt für Wiederaufbau, Reconstruction Credit Institute |
| LDP | Letter of Development Policy |
| MDGs | Millennium Development Goals |
| MDICI | Ministry of Development Investment, and International Cooperation |

| | |
|---|---|
| MELA | Ministry of Environment and Local Affairs |
| MNA | Middle East and North Africa |
| MOF | Ministry of Finance |
| MSMEs | Micro, Small and Medium Enterprises |
| MTEF | Medium-Term Expenditure Framework |
| MTFF | Medium-Term Fiscal Framework |
| NPL | Non-Performing Loans |
| ODC | Cereals Office, *Office des Céréales* |
| OMC | World Trade Organization, *Organisation Mondiale du Commerce* |
| PDO | Program Development Objective |
| PIM | Public Investment Management |
| PIP | Public Investment Projects |
| PEFA | Public Expenditure and Financial Accountabilty |
| PER | Public Expenditure Review |
| PFM | Public Finance Management |
| PforR | Program for Results |
| PPP | Private Public Partnership |
| SCD | Systematic Country Diagnostic |
| SDR | Special Drawing Rights |
| SICARs | Venture Capital Investment Compnay, *Société d'Investissement en Capital Risque* |
| SMEs | Small and Medium Entreprises |
| SOE | State Owned Enterprise |
| SNCFT | National Railroad Company, *Société Nationale des Chemins de Fer* |
| SORETRAS | Regional Transport Company of the Governorate of Sfax, *Société Regionale de Transport du Gouvernorat de Sfax* |
| SOTUGAR | Tunisian Gurantee Company, *Société Tunisienne de Guarantie* |
| SBA | Stand-by Agreement |
| STAM | Tunisian Company of Stowage and Handling ,*Société Tunisienne d'Arrimage et de Mannutention* |
| STEG | Tunisian Gaz and Electricity Company, *Société Tunisienne d'Electricité et de Gaz* |
| STEM | Science, Technology, Engineering and Mathematics |
| STIR | Tunisian Company for Refining Industries, *Société Tunisienne des Industries de Raffinage* |
| STS | Company for Specialized Works, *Société de Travaux Spécialisés* |
| TA | Technical Assistance |
| TTN | Tunisia Trade Net |
| TRANSTU | Tunisian Transport Company, *Société des Transports de Tunis* |
| UGTT | Tunisian General Labor Union, *Union Générale Tunisienne du Travail* |
| UTICA | Tunisian Union of Industry, Trade and Handicraft ,*Union Tunisienne de l'Industrie, du Commerce et de l'Artisanat* |
| VAT | Value Added Tax |
| WBG | World Bank Group |

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**REPUBLIC OF TUNISIA**
BUSINESS ENVIRONMENT AND ENTREPRENEURSHIP
DEVELOPMENT POLICY LOAN

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## SUMMARY OF PROPOSED LOAN AND PROGRAM
### REPUBLIC OF TUNISIA
*BUSINESS ENVIRONMENT AND ENTREPRENEURSHIP*
*DEVELOPMENT POLICY LOAN*

| | |
|---|---|
| Borrower | Republic of Tunisia |
| Implementation Agency | Ministry of Development, Investment and International Cooperation |
| Financing Data | IBRD loan; Amount: Euro 457.2 (US$500 million equivalent) |
| Operation Type | The proposed operation is a standalone single-tranche operation |
| Pillars of the Operation and PDOs | The program development objective is to help Tunisia (i) improve the business environment, and (ii) support entrepreneurship and deepen access to finance. |
| Result Indicators | **PDO 1. Improving the business environment**<br>• Number of anti-competitive practices prevented or eliminated. Baseline: 3 (2016), target: 6 (2018).<br>• Publication and availability on the website of the MDICI of the following: (i) the list of activities subject to investment entry authorization, the deadlines, procedures and the terms and conditions for their granting; (ii) the draft report for consultations as well as the final report on the recommendations and concrete proposals for streamlining investment entry authorizations.<br>• Share of investment projects for which a feasibility study, including a cost-benefit analysis, has been completed during the pre-investment phase. Baseline: 40 percent (2016), target: 80 percent (2018).<br>• Container dwell time. Baseline: 16.6 days (2016), target: 12 days (2018).<br><br>**PDO 2. Supporting entrepreneurship and deepening access to finance**<br>• Amount of seed and equity capital raised from investors. Baseline: TND 200 million (average per year in 2012-2016), target: TND 300 million (average per year in 2017-2018).<br>• Number of private credit bureau licensed and operational. Baseline: 0 (2016), target: one (2018).<br>• Number of cases initiated under the new law on collective procedures. Baseline: 0 (2016), target: 200 (2018).<br>• Number of FOPROLOS loans: Baseline: 286 (per annum in 2013-2015), target: 600 … (2018) |
| Overall risk rating | High |
| Climate and disaster risks | Are there short and long term climate and disaster risks relevant to the operation (as identified as part of the SORT environmental and social risk rating)? No |
| Operation ID | P158111 |

# IBRD PROGRAM DOCUMENT FOR A PROPOSED LOAN TO THE REPUBLIC OF TUNISIA

# BUSINESS ENVIRONMENT AND ENTREPRENEURSHIP DEVELOPMENT POLICY LOAN

## 1. INTRODUCTION, COUNTRY CONTEXT (INCLUDING POVERTY DEVELOPMENTS)

1. **The proposed Business Environment and Entrepreneurship Development Policy Loan (BEE DPL)**, in the amount of Euro 457.2 million (US$500 million equivalent**),** is a standalone single-tranche operation aimed at supporting key areas of reform in the Government of Tunisia's Five-Year Development Plan for 2016-2020. The DPL would help Tunisia achieve stronger and more inclusive growth and private sector-led job creation, particularly by stimulating entrepreneurship.

2. **Six years after the 2011 revolution, Tunisia has made important strides to advance its political transition, but tangible economic dividends in terms of greater economic opportunities for the population are taking longer than expected.** Following the 2011 revolution, Tunisia went through a political transition that led to the adoption of a new Constitution in early 2014, followed by orderly presidential and parliamentary elections in late 2014. These achievements were due in large part to the role of the country's robust civil society (acknowledged by the Nobel Prize for Peace). Civil society organizations, including youth groups, have gained more voice and have pushed for greater transparency and accountability in public service and less corruption. However, the achievements on the economic front are taking longer than expected. As a result of delays in implementing reforms, and because of security-related incidents, social unrest and regional instability (including in neighboring Libya), economic growth averaged only 1.4 percent post revolution (compared to 4.4 percent during the five years before the revolution); gross investment averaged 22.5 percent of GDP (compared to 24.6 percent); export growth averaged 2.2 percent per annum (compared to 5.1 percent); and unemployment averaged 16.2 percent (compared to 12.7 percent).

3. **This weak economic performance poses a risk to past poverty reduction gains, to the promotion of greater inclusion—especially for the middle class—and to Tunisia's young democracy.** While poverty incidence was halved between 2000 and 2010 (from 32.5 to 15.5 percent), considerable disparities exist among regions and age groups, and household vulnerability remains considerable especially in the face of weak post-revolution economic performance. Inequality between regions has risen, with poverty increasingly concentrated in a few regions of the country thereby perpetuating or widening existing disparities. Just as importantly, the data suggests that many households (including middle class) remain slightly above the poverty threshold, making them vulnerable to exogenous shocks such as the loss of employment or hikes in the prices of essential goods. Growth has been inadequate to generate sufficient jobs to absorb new entrants into the labor market. As a consequence, the unemployment rate has remained high (15.5 percent in 2016), especially among women (23.1 percent), young university graduates (31.6 percent), and the population off the coast and in the

south (26.2 percent in the South-East, 23.1 percent in the South-West, and 19 percent in the Center-West compared to 10.7 percent and 9.9 percent in the North-East and Center-East, respectively). Demographic trends suggest that unless the pace of growth accelerates substantially, unemployment will worsen over the next decade. The recurring protests are a reminder that tackling unemployment, especially of youth and in the interior regions where the 2011 revolution started, is critical for social stability.

4. **The Government response to the employment and social challenges by raising public sector hiring and salaries has helped maintain social peace, but has also contributed to significant weakening of Tunisia's fiscal situation.** The number of civil servants (central Government) has increased by about 40 percent since 2010, reaching 650,175 in 2016 (16 percent of the country's active population). In addition, there are about 180,000 workers in public enterprises and 20,870 workers in local government. In late 2015, the Government agreed to a general wage increase schedule with the workers' union. As a consequence, the public wage bill has increased from 10.7 percent in 2010 to 14.5 percent of GDP in 2016 and represents about 60 percent of tax revenues. This trend has contributed to weakening of Tunisia's macroeconomic framework. The twin deficits in 2016 were high, at 6 and 9 percent of GDP for the fiscal and current accounts, respectively. Public debt has risen markedly in the post-revolution period (from 40 percent of GDP in 2010 to 63 percent by end-2016), even though it remains reasonable by international standards.[1]

5. **Going forward, job creation will require a sound macroeconomic framework, a dynamic private sector and a conducive business environment.** Improving the business environment, promoting competition, and opening more space for the private sector remain key challenges for Tunisia; and are critical to unleashing faster and more inclusive private-sector-led growth and job creation. The challenge in the Tunisian context is to further liberalize the economy, reduce rents, and create a level playing field for all private sector actors.

6. **Accelerating job creation and promoting inclusion and shared prosperity in Tunisia also entails supporting entrepreneurship and deepening access to finance.** The existing private sector has been unable to create enough jobs, a situation that has been accentuated in the post-revolution period by the deterioration of the economic situation. As a result and compounding the challenge of creating good jobs, very few new firms enter the market each year. The overwhelming majority enter as small firms and remain small or exit within three to five years.[2] Resolving these challenges through appropriate financial and non-financial support to entrepreneurship will contribute to improving private sector-led growth and job creation. Improving access to finance for small and medium enterprises (SMEs), expanding access to housing finance, and information sharing via credit bureaus are also essential. In addition, the World Bank Group (WBG) is complementing support to policy reforms with concrete actions on the ground to stimulate entrepreneurship and link poor and vulnerable population to economic opportunities, especially for women and in Tunisia's lagging regions. Examples include recent hackathon events for women's economic empowerment (see Box 3),

[1] Debt-to-GDP ratio in a sample of MENA countries (2016): Morocco (64% of GDP), Jordan (87% of GDP), Egypt (86% of GDP).

[2] World Bank (2014): "Tunisia Development Policy Review: The Unfinished Revolution" and World Bank MENA Regional Report (2015): "Jobs or Privileges - Unleashing the Employment Potential of the Middle East and North Africa"

value chain development activities in four investment projects, and an economic inclusion project targeting poor and vulnerable women and youth in lagging areas.

7. **In preparing this operation, the Bank has and will continue to draw lessons from previous DPLs financed during the 2011-2015 transition period.** During the transition period, reform progress was uneven, and in some cases, below expectations. The delays in implementing the needed economic reforms were partly due to the country's nascent and generally fragile political environment, in which emphasis was placed on advancing the political transition through the writing of the Constitution, revamping the electoral laws, reorganizing the government and the judiciary and laws related to fighting terrorism. In addition, most reforms were adopted without a medium-term policy framework during a period of short political cycles. In this sense, the overall level of ambition, political feasibility and institutional capacity were not systematically factored into program design. Moreover, the revolution has introduced into the public arena new voices, the principle of stakeholder consultations and consensus building around reforms. At the same time, some longstanding reforms that seek to open the economy and reduce rents have faced opposition from vested interests leading to reform dilution and delays. In some cases, reforms have been hampered by limited communication about reform objectives and lack of coordination among potential reform winners. Finding ways to support pro-reform coalitions within the administration and among non-Governmental stakeholders is key for implementing timely reforms as well as supporting the new social contract.

8. **The country context has generally improved since the previous DPL series and the new Government has renewed the reform momentum and efforts to improve investor and citizen confidence.** The short political cycles and absence of a medium-term policy framework have now been replaced by the Government's vision layed out first in a "*note orientation*" followed by the Five-Year Development Plan approved by Parliament on April 12, 2017 laying out a comprehensive reform agenda that anchors the reforms supported by this DPL. Since early 2015, progress has been made, especially on statutory reforms that are critical for private investment (e.g., the Competition Law, the Bankruptcy Law, the Banking Law, the Public Private Partnership Law and more recently the Investment Law, etc.). The Government also successfully organized an investor conference in late November 2016 at which it presented progress made since the Presidential and parliamentary elections and called for renewed support of the global community to Tunisia's young democracy. The Government also highlighted improvements in the security situation, ongoing efforts to strengthen the business environment, and the country's investment potential in terms of human and physical capital and location. Moving forward, more attention is needed to accelerate the reforms and their implementation. This includes ensuring that the statutory reforms lead to measurable impacts on the investment climate, both economy wide and in key sectors.

9. **The design of the proposed DPL is also better tailored to the country context and explicitly addresses political and institutional risks.** In particular, the political economy filter, piloted for this operation, is being systematically applied in the reform areas covered by the DPL. The objective of this filter is to help the Bank to better understand the risks, potential mitigation measures, and conditions for successful implementation of the reforms. The timing of the DPL will also be key to its success: given political risks and the contentious nature of reforms, the Government has been conducting the necessary consultations, engaging in a robust

dialogue based on trust, building stronger coalitions for reform, and ensuring that institutional capacity is built to implement the changes.

10. **The proposed DPL is informed by the challenges and opportunities identified in the Systematic Country Diagnostic (SCD).** The SCD identified three key development challenges for Tunisia: **(a) macroeconomic stability:** the macroeconomic and fiscal environment exhibits large vulnerabilities that, if not addressed through deep structural reforms, will prevent the country from achieving its full growth potential; **(b) cohesion and security:** restoring security and social cohesion are prerequisites for setting Tunisia on a new growth trajectory. Attaining longer-term stability and social cohesion require continuous measures to address the economic and social exclusion of large segments of the Tunisian society; and **(c) improved governance:** seven years after the revolution, there is still a clear need to increase accountability, improve service delivery and create more effective means for citizens to participate in policy design and implementation. The SCD also identified two key drivers for eradicating poverty and boosting shared prosperity in a sustainable manner: (a) promotion of private-sector-driven job creation, by simplifying regulations, creating a level playing field, improving access to credit and improving efficiency of the banking system; and (b) increased equality of opportunities through transparent policies that reduce skills mismatch, strengthen the social protection system, address spatial inequalities, and target institutional failures that generate unequal opportunities.

11. **Reforms supported by the proposed DPL are also aligned with the Tunisia Country Partnership Framework (CPF, Report #104123-TN) and the MENA strategy.** The proposed DPL aims at supporting Tunisia's effort to tackle the challenge of promoting stronger and more inclusive private-sector led growth, leading to faster job creation and economic recovery over the medium term. The proposed DPL focuses on two policy areas: (a) improving the business environment; and (b) supporting entrepreneurship and deepening access to finance. There is a special emphasis on completing and implementing the reform agenda that was started during the transition period, and to engage in key new reform areas that are essential for achieving the economic and social objectives of the new Government such as the need to improve the support for entrepreneurship. This DPL is consistent with the MENA strategy's and Tunisia CPF's objectives of tackling the underlying causes and remedying the consequences of conflict and social tension. Specifically, the proposed operation would contribute to the pillar of the MENA strategy on renewing the social contract and pillar 1 of the CPF on restoring an environment conducive to sustainable economic growth and private sector-led job creation. Through this operation, the WBG is also supporting the implementation of the "cascade approach" in Tunisia by promoting greater participation of the private sector in the provision of infrastructure and services.

## 2. MACROECONOMIC POLICY FRAMEWORK

### 2.1 RECENT ECONOMIC DEVELOPMENTS

12. **Tunisia's post-revolution growth performance has been weak in the face of multiple security incidents, political and social instability and delays in reform implementation**. The political transition, recurrent social tensions, sluggish demand, domestic security shocks, the political and security situation in the Middle East and North Africa (including in neighboring Libya), and delays in implementing the needed reforms have negatively affected the Tunisian economy. After growing by 2.4 and 2.3 percent in 2013 and 2014, the economy expanded by only 1.1 percent in 2015. In 2016 the economy grew at an estimated annual rate of 1.0 percent (2.0 percent excluding agriculture). Growth in 2016 was driven mainly by the tradable services sector and the non-tradable activities sector each of which grew by 2.6 percent as well as by manufacturing which grew by 1.0 percent. Non-manufacturing industries (phosphate, oil and gas) contracted by 1.8 percent (compared to -4.1 percent in 2015), as phosphate production in mining regions has not yet fully recovered despite the recent uptick in production levels. The agriculture and fisheries sector contracted by 8.1 percent due partly to poor rainfall (compared to +12.5 percent in 2015).

13. **Inflation has steadily declined and remained subdued in 2016 despite a slight acceleration during the second half of the year in line with the depreciation of the Tunisian dinar.** While electricity tariff hikes associated with the gradual phase-out of electricity subsidies were an important source of inflationary pressures during 2013-2014, food price fluctuations drove headline inflation during this period. In 2016, inflation remained at 3.7 percent on average, against 4.9 percent in 2015, despite a significant depreciation of the dinar since mid-2016. However core inflation - excluding food and energy which include some administered prices - has accelerated slightly since September 2016 and reached 5.1 percent (y-o-y) in December 2016 (against 4.7 percent in December 2015), due in part to the depreciation of the dinar during the second half of the year and to sustained credit and consumption growth.

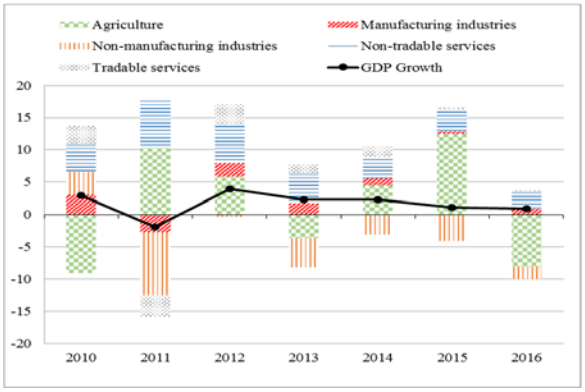
14. **Unemployment has declined from its peak of 19 percent since 2011, in the immediate aftermath of the revolution to 15.5 percent by end-2016 but is still well above the pre-revolution level (13 percent in 2010).** Job creation has remained weak since the revolution and contracted in the aftermath of the two terrorist attacks, in March and June 2015, with a net job destruction of 11,700 jobs in 2015. Net job creation picked up slightly in 2016 with a modest net job creation of 34,700 jobs. Consequently, the employment rate stayed almost flat at 39.8 percent of the working-age population during the same period. Concomitantly, the labor force participation rate remained virtually unchanged at 47.1 percent of the working-age population[3]. As a result, the unemployment rate remained high in end-2016 at 15.5 percent (against 15.4 percent in 2015) and is particularly elevated for women (23.1 percent against 12.5 percent for men), and university graduates (31.6 percent).

15. **The recurring protests are a reminder that unemployment which triggered the 2011 revolution remain a major social concern, especially that of youth, the middle class,**

[3] Between 2015Q3 and 2015Q4 the labor force participation rate of men dropped slightly from 68.6 to 68.3 percent while that of women increased slightly from 26.3 to 26.6 percent.

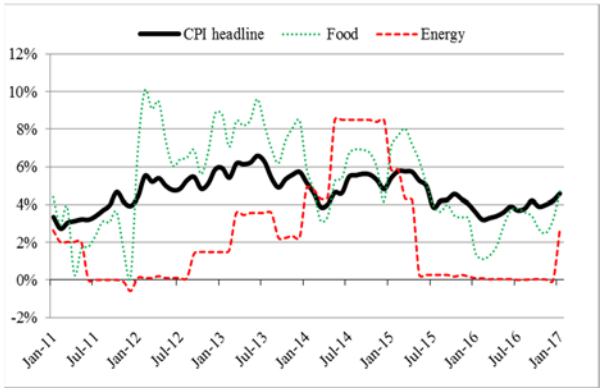
**and in the lagging regions.** The majority of the unemployed are low-skilled workers. However, university graduates have been the group with the highest unemployment rate, which increased from 15 percent in 2005 to 23 percent in 2010 (before the revolution), and to 31.6 percent at end-2016, with female graduate unemployment reaching 41.5 percent. Unemployment rates are also much higher in the lagging regions. The South-East and the South-West are the most affected regions with 23.1 percent and 26.2 percent, respectively, followed by the Center-West, the North-West and the Greater Tunis region. The coastal regions where economic activity is concentrated have lower unemployment rates.

**Figure 1: Contribution to GDP Growth (in percent)**



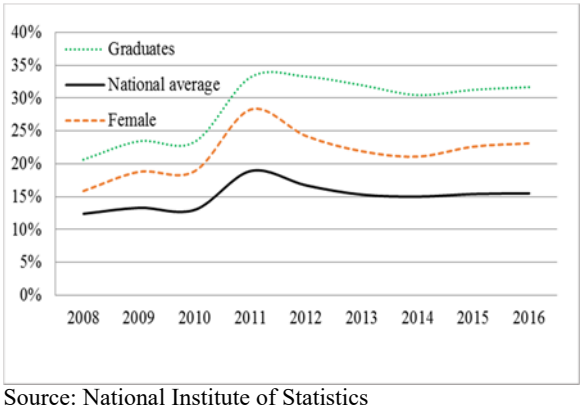

Source : National Institute of Statistics

**Figure 2: Inflation: Headline, Food and Energy (y-o-y change, in percent)**



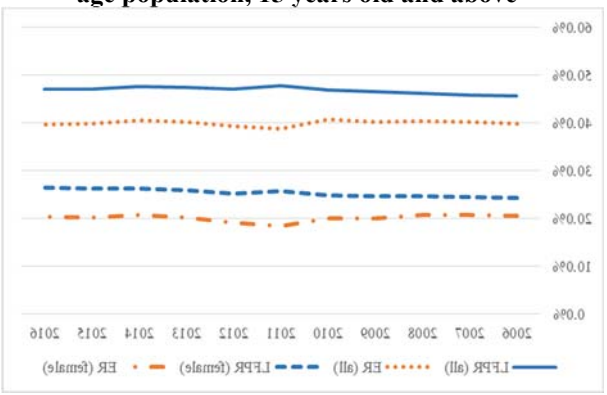

Source: Central Bank

**Figure 3: Unemployment Rates (in percent, eop)**




Source: National Institute of Statistics

**Figure 4: Labor Force Participation Rate (LFPR) and Employment Rate (ER), in percent of working age population, 15 years old and above**

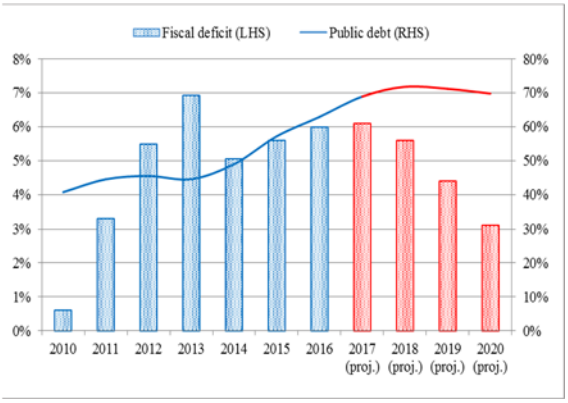


Source : National Institute of Statistics

16. **While the initial 2016 budget envisaged the pursuit of fiscal consolidation, the fiscal deficit remained large.** The deficit (excluding grants) reached 6 percent of GDP (2 percentage points of GDP higher than the initial budget) against 5.6 percent of GDP in 2015. This weak performance was due to: (a) lower than planned tax revenues (20.7 percent of GDP in 2016 against 21.8 percent in 2015), as a consequence of lower growth and weaker tax collection than expected; (b) a higher wage bill (14.5 percent of GDP against 13.6 percent in 2015) due to the implementation of wage increases negotiated in late 2015 and early 2016; (c) slightly higher than budgeted capital expenditures (5.3 percent of GDP in 2016, or 0.2 percent higher than the

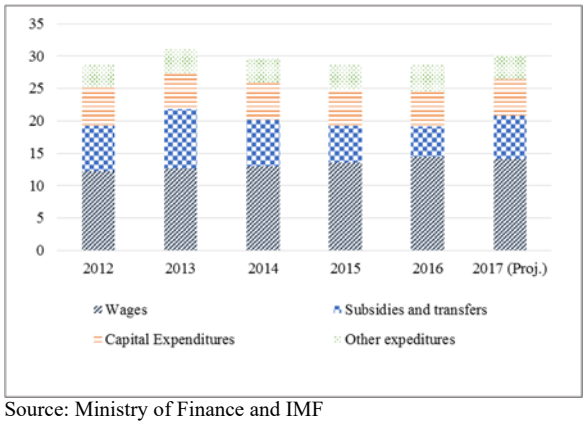
initial budget), thanks to a higher implementation rate. The composition of expenditure remains dominated by current spending, which represents 23.2 percent of GDP. Subsidies and transfers decreased to 4.6 percent of GDP from 5.7 percent in 2015, and from the record high of 10 percent of GDP in 2013, mainly as a result of lower food and energy prices. Public debt reached 62.9 percent of GDP in 2016, up from 57.2 percent of GDP in 2015.

**Figure 5: Fiscal Deficit and Public Debt (in percent of GDP, deficit excl. grants)**




Source: Ministry of Finance, IMF for public debt, and IMF and World Bank staff projections

**Figure 6: Public Expenditures (in percent of GDP)**




Source: Ministry of Finance and IMF

17. **The pension system is structurally in deficit and is putting increasing pressure on the budget (see Box 1).** The deficit of the *Caisse Nationale de Retraite et de Prevoyance Sociale* (CNRPS, National Pension and Social Welfare Fund), the pension scheme covering the public sector, represented TND 375 million in 2015 and TND 420 million in 2016 (around 0.4 percent of GDP). The deficit of the main regime of the *Caisse Nationale de Securite Sociale* (CNSS, National Social Security Fund), the pension scheme covering the private sector, represented more than TND 500 million (0.6 percent of GDP) in 2016. In addition, CNRPS's reserves have been depleted and it currently owes TND 1.2 billion to the *Caisse Nationale d'Assurance Maladie* (CNAM, National Health Insurance Fund) as sickness and maternity contributions collected by CNRPS and due to CNAM but not transferred. This has led to payment delays by CNAM to public and private health providers. In addition CNRPS has received, on average, 0.4 percent of GDP of transfers from the budget during 2015-17.

**Box 1. Tunisia's pension system: challenges, policy initiatives and donor support to advance the reform**

**Tunisia's pension system is in deficit and plagued with challenges.** In particular, the two main pension funds are having considerable and increasing liquidity challenges. There is heavy pressure to ensure the continuity of pension payments even though revenues are increasingly insufficient to provide adequate financing. Consequently, the pension scheme covering the public sector has received support from the public budget in 2015-2017. This crowds out alternative allocations to other social programs, which are needed to satisfy critical demands.

**There is consensus among Tunisian stakeholders about the urgency of the pension system reform, and a commitment to decide on the content of the reform program by mid-summer 2017 and start implementation in early 2018.** The Government and its two main partners – the main trade union (*Union*

*Générale Tunisienne du Travail,* UGTT) and the business confederation (*Union Tunisienne de l'Industrie, du Commerce et de l'Artisanat*, UTICA) – have set up a tripartite committee that has completed the diagnostic of the main challenges facing the system and have agreed to a timetable for the reform. The challenge will be to reach a technically sound and consensual solution. Certain reform measures could be implemented in the near term without jeopardizing future decisions on more comprehensive reform packages. Such near-term general measures (more or less gradually implemented) could include: (a) indexing pensions to inflation; (b) reducing the accrual rate; and (c) increasing the reference wage for pension calculation from ten years to the entire career[4]. In the long term, the strategy will involve (a) designing and implementing a comprehensive and integrated pension and social insurance system: (b) reducing fragmentation; (c) integrating programs consistently; and (d) addressing income inequality and regressivity.

**The reform is being supported in a coordinated manner by the World Bank, the ILO and the IMF.** The approach draws on careful and in-depth analysis and policy discussions, with an awareness of the linkages of the pension system to the civil service and the wage bill, fiscal reforms, as well as the labor market and job creation. The World Bank, the ILO and the IMF are providing technical assistance (TA) to support the reform, and are bringing together the three main stakeholders during training and workshops in order to facilitate the sharing of analysis and data, and the identification and evaluation of specific policy options. The pension reform is also being supported by the IMF Extended Fund Facility (EFF) program.

*Sources of data and information: Government of Tunisia and World Bank mission aide-memoire on technical assistance to pension reform.*

18. **Another source of fiscal risk is the contingent liabilities of state-owned enterprises (SOEs) which are large but remain difficult to assess comprehensively (Box 2).** The deficit of non-financial SOEs in the post-revolution period reached 4.4 percent of GDP in 2013, led by *Société tunisienne de l'électricité et du gaz (STEG), Société des transports de Tunis (Transtu)*, *Tunisair*, *a*nd the *Tunisian Chemical Group.* Budget transfers to these entities increased from about 2 percent of GDP in 2010 to 8.9 percent of GDP in 2013, partly to cover these losses and partly to implement the state's subsidy policy and achieve service delivery and developmental goals. While their overall financial performance has improved, with lower wage bill growth and improved production, many SOEs remained loss making in 2014 (the year for which the latest aggregate SOE financial data are available). In addition, the external debt of public enterprises guaranteed by the state reached 12 percent of GDP in 2016, up from 10 percent of GDP in 2013, with STEG representing over 50 percent. To strengthen its management of contingent fiscal risks, the Government has launched and aims to accelerate implementation of its SOE reform strategy that will improve monitoring of cross-subsidies, consolidate the financial statements of the largest companies, and strengthen the governance and oversight framework of public enterprises.

[4] These short-term measures will respect accepted principles of pension reform developed based on international best practices. These principles include adequacy, affordability, fairness, sustainability, predictability (and transparency), robustness, economic and administrative efficiency, and accessibility (coverage).

**Box 2. Advancing the SOE reform in Tunisia**

**Tunisia's SOEs play an important role in the economy and in service delivery.** The SOE sector consists of 104 enterprises – including social security administrations, according to Tunisia's classification – which operate in 14 sectors. The sectors with the largest number of SOEs include transportation (23), industry (17) and financial services (11). In terms of employment, transport represents 26 percent of the total number of employees in the SOE sector, followed by industry with 21 percent, agriculture 9 percent and financial services 8 percent. Overall, SOEs accounted for close to 4 percent of total employment in 2014 with an aggregate payroll of TND 3.5 billion (4.3 percent of GDP). Their combined revenues reached TND 24 billion in 2014. Moreover, although no balance sheet information is available at the aggregate level, the largest SOEs have very significant assets and manage large investments. Ninety-one SOEs invested, on average, a total of TND 3 billion each year between 2010 and 2014.

**SOEs' financial performance has deteriorated markedly following the 2011 revolution.** While the SOE sector saw its revenues grow slightly between 2010 and 2014, its profits dramatically declined during this period, from TND 1.2 billion to TND 0.2 billion, as labor cost rose significantly (an increase of over TND 800 million between 2010 and 2013) and production was affected by social movements. SOEs received operating and investment subsidies/grants from the state totaling TND 6.7 billion in 2013 (8.9 percent of GDP) and TND 6.1 billion in 2014 (7.5 percent of GDP), partly to cover this loss and partly to implement the state's subsidy policy and to pursue the state's service delivery and development goals. Nine SOEs accounted for the bulk of the transfers (over 99 percent) over this period. The top three recipients – *Societe Tunisienne d'Electricite et de Gaz* (STEG), *Societe Tunisienne des Industries de Raffinage* (STIR), and *Office des Cereales* (ODC) – alone accounted for 87 percent of total transfers in 2013 and 2014. Four transport companies also received a total of TND 517 million during 2013-2014.

**Given the lack of recent and complete information, the current financial position of these SOEs is not publicly available.** No information on the SOE sector as a whole for 2015 is publicly available, and the data compiled by the Government corresponds to the unconsolidated (i.e., parent company only) financial statements. Audit reports obtained for some of the largest SOEs included qualifications, which cast further doubt on their financial situation.

**Government has called for profound reform of the SOE sector but the challenge is to launch and accelerate the implementation of the reforms.** In November 2015, the Council of Ministers adopted an SOE Reform Strategy for 2016-2020 based on the Five-Year Plan, which was publicly disseminated at the SOE Symposium in November 2016. An ambitious Action Plan for 2016-2017 was submitted along with the Reform Strategy. The Reform Strategy and Action Plan provide many of the policy and technical solutions and actions needed to improve SOE performance but there has been little progress in advancing the reform. Moving forward, successful reform will therefore require top political support and leadership, the identification of entry points for the reform[5] and strong and coordinated donor support.

[5] Several entry points for the reform have been discussed with Government during TA activities: (i) creation of a clearly designated ownership entity to carry out the state's shareholder rights whose main objectives and functions are to: define SOE mandates and objectives; develop a structured and transparent policy for nominating SOE boards and support/facilitate the selection process; develop a clear framework for the treatment of public service obligations; reactivate the system of performance contracts and develop and implement a proper performance management system for SOEs, using a pilot group of SOEs to begin with Promote good corporate governance practices in SOEs and monitor and measure SOE compliance with the new framework and regulations; (ii) launch an internal governance improvements in pilot SOE.

**International financial institutions (IFIs) and bilateral development agencies are providing coordinated TA and policy-based financing to advance the SOE reform.** The World Bank has fielded missions and developed a TA program to support the reform, and coordinates closely with the other partners particularly the IMF and the *Agence Francaise de Developpement* (AFD). Following adoption of the SOE reform strategy under the IMF Stand-by Arrangement (SBA) program, the new IMF program is supporting the adoption of performance contracts for five of the largest companies: STEG, STIR, the Office des Céréales, Tunisair, and the Régie Nationale des Tabacs. The AFD is preparing a three-year policy-based operation with TA to support the global and internal governance axes of the reform strategy.

*Sources of data and information: Annual report on the performance of SOEs, 2010-14, Government of Tunisia; and World Bank Technical Note on SOE reform*

19. **While the Central Bank has maintained a prudent monetary policy, lack of liquidity has increased since the revolution, reflecting the sharp deterioration of the current account and slow deposit growth.** Following a period of gradual increase of its policy rate, to 4.75 percent in June 2014 against 3.75 percent in August 2012, the Central Bank reduced its policy rate by 50 basis points to 4.25 percent in October 2015. The aim was to stimulate private sector credit growth in a context of weak economic activity and decelerating inflation. Liquidity (M3) growth slightly accelerated by 7.5 percent in 2016 against 5.3 percent in 2015, led mainly by a significant increase in credit to the government (29.9 percent in 2016), but also by faster credit to the economy (9.8 percent in 2016). In late April 2017, the Central Bank increased its policy rate by 50 basis points to 4.75 percent, following the rising inflationary pressures observed during the last quarter of 2016 and first quarter of 2017. Weak economic activity, the poor performance of banks in recent years, and limited deposit growth have tightened the liquidity of banks. The pressure on liquidity has worsened due to the Government's deficit financing from the domestic market and the Central Bank's interventions in the foreign exchange market to limit the depreciation of the dinar. Central Bank refinancing reached TND 7.5 billion as of December 2016 against TND 5.4 billion a year earlier.

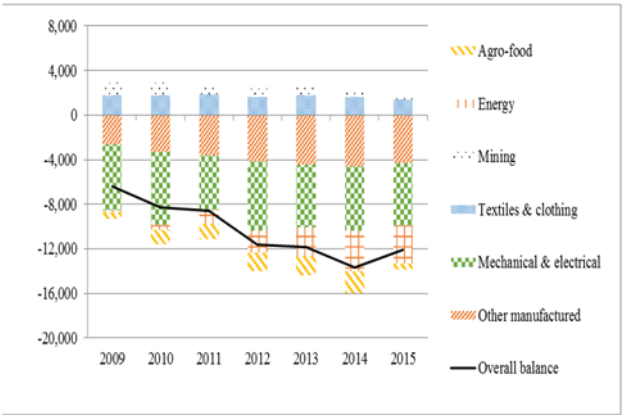
20. **The recapitalization of public banks in 2015 has helped reduce vulnerabilities in the banking sector.** Public banks represent a third of system assets, and the most troubled one represents about 10 percent of system assets. Thanks to the recapitalization of two public banks, the capital adequacy ratio improved from 9.4 percent in December 2014 to 11.6 percent in December 2016. New prudential rules and better enforcement have increased the provisioning rate from 46 percent in 2012 to 59 percent in December 2016. Non-performing loans (NPLs) on a gross basis have remained high (15.6 percent in December 2016, against 15.8 percent in December 2014 and 13 percent in 2010) because public banks face legal obstacles to sell, restructure, or liquidate real estate collateral. NPLs could increase further, notably due to the weak tourism sector, which represents at least 25 percent of NPLs. In order to modernize and improve banking system regulation, governance and resilience, the Government and Parliament adopted new laws on competition, bankruptcy, banking, and the Central Bank in the first half of 2016. One public bank still poses a fiscal risk on the order of 0.5 percent of GDP, should an arbitration judgment go against the Government. The World Bank is preparing a Program-for-Results operation on state-owned bank restructuring.

21. **The current account deficit has deteriorated sharply since the revolution.** It reached 8.5 percent of GDP, on average, in 2011-2016, against 2.7 percent of GDP in 2005-2010. In

2016, it was at 9 percent of GDP, against 8.9 percent of GDP in 2015. A combination of slow growth in Tunisia's major trade partners in Europe, domestic and regional political and security challenges, and social movements have severely affected Tunisia's export performance. The trade deficit was reduced to 11.4 percent of GDP in 2016, from a record high of 14 percent of GDP in 2014. Despite a slight increase of tourist arrivals, mainly from non-European countries, tourism receipts continued to decrease in 2016 (by 3.8 percent) but at a much slower pace than in 2015, when Tunisia lost a third of its tourism receipts following two terrorist attacks. Workers' remittances remained stable. FDI increased in nominal terms by 4.6 percent in 2016 (against 8.9 percent in 2015) but represented only 2 percent of GDP in 2016 against an average of 4 percent of GDP before the revolution (2008-2010). The energy sector still accounts for the largest share of FDI inflows, 46.7 percent in 2016 (against 49.3 percent in 2015), followed by the industrial sector at 38.6 percent (up from 28.8 percent in 2015). While the current account deficit remained high in 2016, disbursements from donors were significantly lower than expected. Gross international reserves therefore fell to US$5.9 billion at the end of 2016 against US$7.4 billion a year earlier. The Tunisian dinar depreciated by 12 percent against the US dollar and by 9 percent against the Euro in 2016. The dinar depreciated by an additional 2.5 percent against the US dollar and 3 percent against the Euro between April 18 and April 24, 2017.

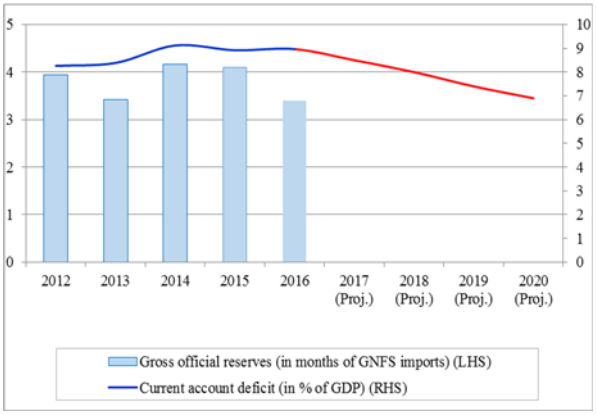
22. **Since the revolution, Tunisia has relied mainly on official resources to finance its growing balance of payments deficit.** Following the issuance of bonds with US guarantees in 2012 and 2014, and with a Japanese guarantee in 2014, the Government successfully raised US$1 billion by issuing a Eurobond without guarantees in early 2015. In 2016, in addition to the IMF program (about US$320 million), budget support from the European Union (US$492 million) and the African Development Bank (US$500 million), the Government successfully raised US$500 million in the US market with a US guarantee. Ratings have remained unchanged since the repeated downgrades of 2013, except for Fitch, which downgraded Tunisia from B+ to BB- in early February 2017, and Ratings and Investment Information (R&I), which downgraded Tunisia by a notch from BBB- to BB+ in December 2015. The Government successfully raised Euro 850 million in early February 2017, a sign of continued confidence from investors.

**Figure 7: Trade by Product and Trade Balance (in TND million)**




Source: National Institute of Statistics

**Figure 8: Current Account Deficit and Reserves**




Source: Central Bank, IMF and World Bank staff projections

## 2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

23. **The economy is expected to pick up gradually in the coming years.** GDP growth is projected to expand modestly by 2.3 percent in 2017 as a result of relatively abundant rainfall in recent months and improved social stability that will help the recovery of industrial production notably of phosphate and manufacturing industries, and stronger tourism growth. Nevertheless, economic growth remains sensitive to security risks, social stability and growth in Europe. CPI inflation is expected to slightly increase during 2017 but to gradually decelerate as monetary policy tightens slightly. In the medium term, economic growth is projected to gradually pick up to 4.1 percent by 2020 in a scenario that would combine the acceleration of structural reforms, the reinforcement of security and greater political and social stability.

**Table 1: Tunisia: Selected Macroeconomic Indicators, 2012-2020**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 (Proj.) | 2018 (Proj.) | 2019 (Proj.) | 2020 (Proj.) |
|---|---|---|---|---|---|---|---|---|---|
| **Real Sector** | | | | | | | | | |
| Real GDP growth (% change) | 3.9 | 2.4 | 2.3 | 1.1 | 1.0 | 2.3 | 3.0 | 3.5 | 4.1 |
| Unemployment rate (% of active population) | 16.7 | 15.3 | 15.0 | 15.4 | 15.5 | .. | .. | .. | .. |
| Inflation (CPI, average) | 5.1 | 5.8 | 4.9 | 4.9 | 3.7 | 4.3 | 4.2 | 4.0 | 3.8 |
| Gross Domestic Investment (% of GDP) | 24.4 | 22.7 | 23.2 | 21.4 | 22.5 | 23.2 | 23.3 | 23.8 | 24.5 |
| Gross National Savings (% of GDP) | 16.1 | 14.4 | 14.0 | 12.5 | 13.5 | 14.7 | 15.3 | 16.4 | 17.5 |
| **Government finance (% of GDP)** | | | | | | | | | |
| Total Revenues (including grants) | 24.2 | 24.3 | 24.9 | 23.6 | 22.7 | 24.3 | 24.7 | 24.5 | 24.6 |
| Total expenditure and net lending | 28.7 | 31.0 | 29.5 | 28.8 | 28.7 | 30.2 | 30.1 | 28.6 | 27.5 |
| Overall balance (excluding grants) | -5.8 | -7.5 | -4.3 | -5.6 | -6.0 | -6.1 | -5.6 | -4.4 | -3.1 |
| Overall balance (including grants) | -4.9 | -7.4 | -3.9 | -5.3 | -5.9 | -5.9 | -5.4 | -4.1 | -2.9 |
| Public debt ratio (% of GDP) | 45.5 | 44.5 | 49.0 | 57.2 | 62.9 | 68.9 | 71.8 | 71.2 | 69.8 |
| **Selected Monetary Accounts (Annual percentage change, unless otherwise indicated)** | | | | | | | | | |
| Money and quasi-money (M2) | 8.2 | 7.0 | 8.2 | 5.2 | 7.8 | 8.6 | 7.4 | 7.7 | 8.2 |
| Credit to the economy | 8.8 | 6.8 | 9.4 | 6.2 | 9.8 | 7.0 | 7.5 | 8.2 | 8.8 |
| Policy interest rate (%, eop) | 3.75 | 4.50 | 4.75 | 4.25 | 4.3 | .. | .. | .. | .. |
| **Balance of Payments (Percent of GDP, unless otherwise indicated)** | | | | | | | | | |
| Current account balance | -8.3 | -8.4 | -9.1 | -8.9 | -9.0 | -8.5 | -8.0 | -7.4 | -6.9 |
| Exports of goods | 37.7 | 36.9 | 35.2 | 32.6 | 32.3 | 33.4 | 34.2 | 33.7 | 33.2 |
| Imports of goods | 51.3 | 49.7 | 49.2 | 44.3 | 43.7 | 44.7 | 45.1 | 44.5 | 43.7 |
| Foreign Direct Investment, net | 3.5 | 2.3 | 2.2 | 2.6 | 2.0 | 2.4 | 2.7 | 2.3 | 2.3 |
| Gross reserves (US$ billion, eop) | 8.7 | 7.7 | 7.7 | 7.4 | 5.9 | … | … | … | … |
| in months of next year's goods and non-factor services imports 1/ | 3.9 | 3.4 | 4.2 | 4.1 | 3.4 | … | … | … | … |
| External debt | 53.0 | 57.0 | 61.4 | 64.9 | 70.1 | 76.7 | 80.5 | 80.1 | 78.6 |
| Exchange rate, average (TND/US$) | 1.56 | 1.63 | 1.70 | 1.96 | 2.1 | … | … | … | … |
| Memorandum item | | | | | | | | | |
| Nominal GDP (TND million) | 70,354 | 75,144 | 80,790 | 84,656 | 90,376 | 97,397 | 104,603 | 112,404 | 121,225 |
| Nominal GDP (US$ million) | 45,047 | 46,234 | 47,521 | 43,156 | 42,074 | .. | .. | .. | .. |
| GDP per capita (current US$) | 4,179.7 | 4,246.9 | 4,321.4 | 3,868.9 | 3,733.5 | .. | .. | .. | .. |

Source: IMF, Tunisian authorities and World Bank staff estimates; IMF for public debt
1/ End-of-year reserves over next year's imports

### *Fiscal policy*

24. **The fiscal deficit is projected to stabilize at 6.1 percent of GDP in 2017 and to start decreasing gradually in 2018, to an average of 4.4 percent of GDP in 2018-2020.** Reining in the public wage bill, reforming the pension system and reducing SOE risks are critical for containing the deficit in the short term, as well as medium-term fiscal sustainability. This will also require strengthening public investment management to improve the quality and efficiency of public investment in the context of the 2016-2020 Five-Year Development Plan. A core objective of the IMF's EFF program is to support the Government's efforts to contain and reduce the wage bill and implement a comprehensive civil service reform. The implementation of the pension, civil service, and SOEs reforms (Box 2) will strengthen fiscal sustainability and open space for investment spending. Improving the quality of investment projects and resolving bottlenecks in project implementation through better public investment management are critical to enhance the growth and social impact of public investment under the 2016-2020 Five-Year Development Plan.

**Table 2: Tunisia: Key Fiscal indicators 2012-2020 (in percent of GDP)**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 (Proj.) | 2018 (Proj.) | 2019 (Proj.) | 2020 (Proj.) |
|---|---|---|---|---|---|---|---|---|---|
| **Overall balance (excluding grants)** | **-5.8** | **-7.5** | **-4.3** | **-5.6** | **-6.0** | **-6.1** | **-5.6** | **-4.4** | **-3.1** |
| **Overall balance (including grants)** | **-4.9** | **-7.4** | **-3.9** | **-5.3** | **-5.9** | **-5.9** | **-5.4** | **-4.1** | **-2.9** |
| Primary balance | -4.0 | -5.6 | -2.5 | -3.7 | -3.8 | -3.9 | -3.1 | -1.9 | -0.6 |
| **Total revenue (including grants)** | **24.2** | **24.3** | **24.9** | **23.6** | **22.7** | **24.3** | **24.7** | **24.5** | **24.6** |
| Tax Revenues | 21.1 | 21.7 | 23.1 | 21.8 | 20.7 | 22.2 | 22.6 | 22.8 | 22.8 |
| Non-tax revenues | 2.0 | 2.3 | 1.3 | 1.4 | 1.9 | 1.9 | 1.8 | 1.5 | 1.5 |
| Grants | 0.9 | 0.3 | 0.5 | 0.3 | 0.1 | 0.3 | 0.3 | 0.2 | 0.2 |
| **Total expenditures and net lending** | **28.7** | **31.0** | **29.5** | **28.8** | **28.7** | **30.2** | **30.1** | **28.6** | **27.5** |
| Current expenditures | 22.7 | 25.3 | 23.7 | 23.3 | 23.2 | 24.6 | 24.3 | 22.8 | 21.3 |
| Wages and salaries | 12.2 | 12.7 | 13.0 | 13.6 | 14.5 | 14.1 | 14.8 | 13.1 | 12.1 |
| Goods and services | 1.6 | 1.7 | 1.7 | 2.0 | 1.9 | 1.5 | 1.5 | 1.4 | 1.4 |
| Interest payments | 1.8 | 1.9 | 1.9 | 1.9 | 2.2 | 2.2 | 2.5 | 2.5 | 2.5 |
| Transfers and subsidies | 7.0 | 9.1 | 7.2 | 5.7 | 4.6 | 6.7 | 5.5 | 5.5 | 5.1 |
| Other expenditures (non-allocated) 1/ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | 0.2 |
| Capital expenditures and Net lending | 6.0 | 5.6 | 5.8 | 5.5 | 5.4 | 5.6 | 5.8 | 5.9 | 6.2 |
| o.w. Bank recapitalization | 0.0 | 0.0 | 0.0 | 0.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Float 2/ | 0.3 | -2.3 | -1.0 | -0.3 | -0.5 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Overall balance (including grants, cash basis)** | **-4.6** | **-7.4** | **-4.9** | **-5.5** | **-6.4** | **-5.9** | **-5.4** | **-4.1** | **-2.9** |
| **General Government Financing, net** | **4.6** | **7.4** | **4.9** | **5.6** | **6.4** | **5.9** | **5.4** | **4.1** | **2.9** |
| External (net) | 3.6 | 1.4 | 4.6 | 5.1 | 2.8 | 5.4 | 4.3 | 2.4 | 2.0 |
| Domestic (net) | 1.8 | 6.0 | 1.8 | 0.5 | 3.6 | 0.4 | 1.1 | 1.7 | 0.9 |
| Of which : confiscated revenues and privatization rec | 0.6 | 0.6 | 0.1 | 0.1 | 0.6 | 0.2 | 0.2 | 0.2 | 0.2 |

Source: IMF, Tunisian authorities and World Bank staff estimates
1/ 2013 includes repayment of arrears on energy subsidies accumulated in 2012
2/ Difference between the cash and accrual central government overall deficit data at the end of the period
3/ Confiscated revenues are the assets confiscated from the former regime's personal assets that are sold

### *Inflation and monetary policy*

25. **In the medium term, notwithstanding a narrowing of the output gap, inflation is expected to decline on the back of lower international oil and commodity prices and tighter**

**monetary policy.** The Government is taking measures to simplify capital account regulations and to improve foreign exchange liquidity management. The greater autonomy of the Central Bank conferred by the new Central Bank Law is also expected to clarify its role as the lender of last resort. In addition, Central Bank interventions in the foreign exchange market are being gradually reduced through the newly introduced auction mechanism, which will bring greater flexibility to the exchange rate.

### *External position*

26. **The current account deficit is expected to slowly recover in the medium-term thanks to improved production of phosphate and services exports (mainly tourism) under the scenario of improved social stability and security.** Manufacturing exports, notably textile, mechanical and electrical products are expected to grow in line with slow growth in Europe. Oil and gas exports are projected to pursue their declining trend, with extraction from new sites only partially offsetting extraction in less productive and older sites. In the baseline scenario, it is assumed that phosphate production does not fully recover even in the medium term due to the volatility of the social situation in the mining sector. Services exports, mainly tourism, could slowly recover in the medium term, assuming improvement in the security situation. Under these assumptions, the current account deficit should narrow progressively to 8.5 percent of GDP in 2017 and 6.9 percent of GDP by 2020. FDI is also expected to recover only gradually, due to weak European growth and depending on social and security conditions in Tunisia.

**Table 3: External Financing Needs 2015-2020 (in US$ millions)**

| | 2015 | 2016 | 2017 (Proj.) | 2018 (Proj.) | 2019 (Proj.) | 2020 (Proj.) |
|---|---|---|---|---|---|---|
| Current account deficit | 3,849 | 3,776 | 3,420 | 3,141 | 3,071 | 3,030 |
| External medium and long-term debt amortization | 1,209 | 1,492 | 2,170 | 1,658 | 1,818 | 1,471 |
| Short-term debt | 6,846 | 6,565 | 5,909 | 5,842 | 5,934 | 6,240 |
| **Total requirements** | **11,904** | **11,832** | **11,500** | **10,640** | **10,822** | **10,742** |
| FDI and portfolio investment, net | 1,118 | 832 | 965 | 1,061 | 1,116 | 1,181 |
| Disbursements | 3,558 | 2,428 | 4,102 | 3,224 | 2,798 | 2,387 |
| Donors financing (including World Bank and budget grants) | 1,370 | 577 | 927 | 780 | 850 | 1,300 |
| IMF credits, net | 301 | 299 | 325 | 238 | 366 | 198 |
| Financial Market Acess and other | 88 | 603 | 1,953 | 1,417 | 918 | 418 |
| Short term debt | 6,565 | 5,909 | 5,842 | 5,934 | 6,240 | 6,421 |
| Other flows net (incl. drawdown in commercial banks NFA) | 1,049 | 2,174 | 1,884 | 1,272 | 917 | 987 |
| **Total resources** | **12,290** | **11,343** | **12,793** | **11,491** | **11,071** | **10,976** |
| Change in foreign reserves | 386 | -489 | 1,285 | 850 | 249 | 235 |
| **Total Financing** | **11,904** | **11,832** | **11,508** | **10,640** | **10,822** | **10,742** |

Source: IMF, Tunisian authorities and World Bank staff estimates

### *Debt sustainability analysis*

27. **Debt levels have risen markedly in the post-revolution period, but remain reasonable by international standards**. After dropping from 52 percent of GDP in 2005 to 40 percent in 2010, public debt has risen to 57.2 percent of GDP in 2015. In parallel, external debt has increased to 64.9 percent of GDP in 2015 after dropping to 48 percent of GDP in 2010 from above 60 percent of GDP in 2005. The increase in debt levels reflects the impact of expansionary fiscal policy due to public hiring and collective wage bargaining. It also reflects responses to security shocks, widening current account deficits, currency depreciation, and low growth.

Under current baseline scenarios of low and slowly recovering growth over 2017-2019 and moderate fiscal consolidation accelerating in 2018, central government debt is expected to peak at 71.8 percent of GDP in 2018 before declining to 69.8 percent by 2020.[6]

28. **The debt sustainability analysis (DSA) shows that public debt dynamics are vulnerable to a slower fiscal adjustment path, lower growth, and the realization of contingent liabilities or a large depreciation of the exchange rate.** Tunisia enjoys long maturity and low average interest rates on its debt, reflecting its reliance on foreign financing and multilateral donors. However, about 66 percent of public debt is denominated in foreign currency. Contingent liabilities due to weak public banks, ailing SOEs and pensions could increase financing needs and therefore pose a substantial source of risk. The results of the DSA for public debt (see Annex 4) suggest that under most scenarios (including higher fiscal deficit; negative shocks to growth, the real interest rate or the exchange rate; and the realization of contingent liabilities) the public debt-to-GDP ratio would peak between 77 and 88.9 percent depending on the severity of the shock. In particular, the realization of contingent liabilities of about 10 percent of GDP could push up the debt-to-GDP ratio to 85 percent in the year of the shock, before declining to 83.3 percent by the end of 2020. An exchange rate shock of 13 percent real deprecation (the maximum historical movement) could push up the debt-to-GDP ratio to 77 percent in the near term before declining to 74.1 percent by 2020. A combined macro-fiscal shock (low growth, higher real interest rate, and slower fiscal adjustment path) would increase the debt-to-GDP ratio to 86.1 percent before it declines gradually to approximately 84.4 percent by 2020.

29. **The World Bank is providing TA to help Tunisia improve its technical and institutional capacity to manage public debt**. In coordination with IMF support, including on cash management, the World Bank TA has helped Tunisia analyze and develop guidelines on the borrowing mix that best fits the Government's objective of lowering financing costs while keeping portfolio financial risks under control. This strategy is laid out in the Medium Term Debt Strategy (MTDS) approved by the Minister of Finance in December 2016. Aiming to support the Government's objective of improving debt management, the TA has assessed current institutional arrangements for debt management and recommended the creation of a debt and treasury office with the capacity to engage in (a) market transactions (e.g., issuance in international capital markets, active management of the debt and government cash balance); (b) risk assessment of all government loan guarantees and on-lending; and (c) other areas where strengthening the capacity of the administration is critical to ensure policy implementation.

***Risks to the macroeconomic outlook***

30. **The main risks to the economic outlook are political and social instability and the security concerns.** While the Government is deploying resources to improve the security situation the high level of youth unemployment notably in the lagging regions may result in social tensions which remain one of the main risks the country has been facing since the revolution. The Government is facing the challenges of balancing between social stability and the need for fiscal consolidation, notably in the civil service and SOEs reforms. Moreover,

[6] In the baseline scenario, external debt would peak at 80.5 percent of GDP in 2018 before declining to 78.6 percent by 2020.

reform implementation to stimulate private sector growth and job creation and entrepreneurship is key to unleash private sector dynamics, create opportunities and hope for the future.

***Overall assessment of macroeconomic policy stance***

31. **Overall, the country's macroeconomic policy framework is adequate**. The Government is committed to fiscal consolidation and macroeconomic stability, including through the new EFF with the IMF.

2.3 IMF RELATIONS

32. **Following the expiration of the two-year Stand-by Agreement (SBA)[7] in December 2015, the IMF and Tunisia signed a four-year EFF in the amount US$2.8 billion, including about US$320 million disbursed following approval in May 2016. On April 17, 2017, the IMF and the Tunisian Government reached a staff-level agreement on the policies needed for the completion of the first review of the program.** The IMF EFF program's main goals are to: (a) consolidate macroeconomic stability, in particular by containing the wage bill and laying the groundwork for civil service reform, advancing tax and energy subsidy reforms, simplifying existing capital account regulations, increasing the flexibility of the exchange rate and reducing its overvaluation; (b) promote financial intermediation through the adoption and implementation of banking legislation (bankruptcy, banking and Central Bank laws), continued progress in restructuring public banks, and lifting legal barriers to the resolution of NPLs; and (c) improving the investment climate by seeking implementation of the Competition and PPP laws, adoption of the Investment Code, and the simplification of administrative procedures. The Bank and the IMF have been collaborating closely during the preparation of this operation and the EFF, notably on civil service, pension, business environment and financial sector reforms.

## 3. THE GOVERNMENT'S PROGRAM

33. **Following the 2014 presidential and parliamentary elections, the Government developed a concept note (*Note d'Orientation Stratégique)* for the 2016-2020 development plan, followed by an elaborated Five-Year Development Plan, which was approved by Parliament on April 12, 2017.** These two documents outline Tunisia's development vision and strategic orientation for the next five years. They clearly state that Tunisia will rely on the private sector to lead economic growth and job creation, and at the same time promote a participatory approach to policymaking.

34. **The two documents present a new development model that aims at achieving "economic efficiency based on innovation and partnership, social inclusion and sustainable development."** Achieving these objectives requires improvement of the business environment and progress in the implementation of major reforms, including modernization of the administration, revision of the procurement system, promulgation of a new Investment

[7] Between 2013 and 2015, Tunisia had a 24-month SBA with the IMF in the amount of US$1.61 billion (SDR 1.146 billion, 400 percent of Tunisia's quota) approved by the Fund on June 7, 2013. The SBA was extended by seven months until December 31, 2015 to allow the GoT more time to implement agreed policy measures. Total disbursements under the SBA reached US$1.51 billion in six reviews.

Code, improved equity of the tax regime, and implementation of policies to boost public-private partnerships. The Five-Year Plan emphasizes three axes of economic reform:

- **Axis 1 – Better economic governance.** This set of actions will focus on: (a) fighting against corruption, reinforcing regional autonomy, facilitating access to information, and protecting individual rights; (b) improving SOE governance, emphasizing transparency and accountability, and ensuring financial sustainability; and (c) reforming the administration by investing in digital open government platforms and improving the quality of service delivery to citizens and enterprises.

- **Axis 2 – Business climate and promotion of private investment.** These actions will focuses on: (a) restoring confidence by strengthening the rule of law, improving competition, and introducing budgetary management by objectives; (b) modernizing productive sectors, focusing on high value addition and integration in global value chains; (c) improving competitiveness, liberalizing economic activities, modernizing logistics infrastructure, pursing R&D, and improving the quality assurance and certification infrastructure; (d) integration in global markets via export development programs, and strengthening economic diplomacy; (e) promulgating the new Investment Code and encouraging FDI; (f) promoting large projects; and (g) removing obstacles related to land and property allocation.

- **Axis 3 – Financing of the economy.** Actions will focus on: (a) fiscal and customs reform: reducing the tax burden on businesses and individuals, enforcing tax collection, integrating the informal economy, and modernizing tax and custom administration; (b) banking reform: adopting a new Banking Law, modernizing the governance of public banks, improving SME finance mechanisms; and (c) capital markets reform: increasing market capitalization, supporting long-term saving, energizing the secondary market for financial products, and reviewing legislation governing financial markets.

35. **The reform momentum has generally accelerated since the new Government took office, and the focus has shifted to implementation.** Since the fall 2015, the Parliament has approved several pieces of legislation, including the Law on Access to Information, the Competition Law, the PPP Law, the Law governing the Central Bank, the Law on Collective Procedures, the Banking Law, and more recently the Investment Law. The challenge now is to implement these reforms.

36. **Civil society continues to play an important role in the post-transition period.** In early June 2016, President Béji Caïd Essebsi asked for the formation of a national unity Government that would unite politicians, employers and the largest workers' union. The national unity Government now includes the main trade union (*Union Générale Tunisienne du Travail*, UGTT) and the main business confederation (*Union Tunisienne de l'Industrie, du Commerce et de l'Artisanat,* UTICA), which were part of the quartet that secured Tunisia's democratic transition, winning them a Nobel Peace Prize. The UGTT and UTICA also played an important role in conceiving of a "new Social Contract" for Tunisia. Signed in January 2013, it is a consensual action plan that paves the way for key reforms in the social sectors (social security reform, subsidy reform, vocational training reform). In July 2016, these and other stakeholders, together with the main political parties, signed the **Carthage Agreement,** which

lays out the roadmap that the national unity Government should follow to solve Tunisia's economic and social crises. The roadmap is aligned with the Five-Year Development Plan and puts strong emphasis on the fight against terrorism, fiscal sustainability, regional development, the need to accelerate growth and employment, and the need to improve governance and the performance of the civil service. As a result of the Carthage Agreement and the roadmap, the new Government is characterized by greater participation of civil society and accountable decisionmaking to ensure endorsement of the reforms under preparation.

## 4. THE PROPOSED OPERATION

### 4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

37. **The proposed DPL is a standalone single-tranche operation aimed at improving the business environment, supporting entrepreneurship and increasing access to finance.** It is designed to support key areas of reform in the Government's Five-Year Plan for 2016-2020 and to help advance the economic reforms initiated during the political transition, the implementation of which are essential for achieving the Government's economic objectives. The operation is strongly linked to Axis 2 and Axis 3 under the Five-Year Plan, putting the private sector at the heart of the growth and jobs agenda, creating a level playing field for competition, and deepening financing for young firms and entrepreneurs. The operation also contributes to the goals of Axis 1 in terms of improving governance, transparency, and service delivery.

38. **The DPL is organized under two key pillars:** (a) improving the business environment; and (b) supporting entrepreneurship and deepening access to finance. The reforms supported by this operation were developed during intensive policy dialogue between the Government and the Bank, and benefitted from continuous technical support to ensure that they adhere to quality standards and produce expected development outcomes in terms of economic and social opportunities.

39. **A political economy filter is being piloted in this operation to help ensure that reform measures are informed not only by strong technical knowledge but also by a sound understanding of potential institutional and political bottlenecks, as well as local capacities and opportunities.** The political economy filter aims to contribute to improving political buy-in and the success of reforms through a systematic review of the political and institutional risks and viability of each of the prior actions during the preparation of the operation. The review helps identify ways to address potential opposition to reforms. Deeper engagement on key areas may be developed in the next DPL based on the identification of client needs.

### 4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

40. **The policy matrix as described in Annex 1 includes eight prior actions.** This section provides a detailed description of the reform agenda in the two policy areas and the specific prior actions supported by this operation.

**Improving the business environment**

***Prior Action #1: The four implementing decrees of the new Competition Law No. 2015-36 dated September 15, 2015 - Decree No. 2016-780 dated June 13, 2016, Decree No. 2016-1148 dated August 19, 2016, Decree No. 2016-1204 dated October 18, 2016, and Decree No. 2017-252 dated February 8, 2017- have been published in the Official Gazette No. 51 dated June 24, 2016, the Official Gazette No. 72 dated September 2, 2016, the Official Gazette No. 87 dated October 25, 2016, and the Official Gazette No. 13 dated February 14, 2017, respectively.***

41. *Rationale:* An uneven playing field limits private sector participation and reduces economic opportunities for growth. Despite successive improvements of the competition policy framework, the effectiveness of antitrust enforcement has not been fully achieved. In the past, the Competition Council focused its enforcement efforts on the analysis of cases related to predatory pricing, but merger reviews and anti-cartel enforcement are limited. Overall, the effectiveness of law enforcement is hampered by the lack of substantial evidence on anticompetitive behavior, limited economic analysis of the potential anticompetitive effects of firms' behavior, a narrow focus on ex-post review of potential bid rigging practices in public procurement, and insufficient deterrent effect of fines. The dual institutional framework responsible for antitrust enforcement (Competition Council/Ministry of Commerce) prevents efficiency in combating anticompetitive behavior and impeding the anticompetitive effects of mergers, with the latter retaining broad discretionary powers during the merger review process. Lack of competitive neutrality between SOEs and private companies is translated into state support measures and subsidies, such as capital injections and guarantees for SOEs in financial difficulty, putting pressure on the state budget. Preferential treatment of nationals in the regulatory framework prevents the development of open markets. Restrictions on foreign capital participation and additional administrative requirements limit competition and entry in several sectors.

42. *Policy reform:* The Government has launched a reform process to increase the effectiveness of implementation of the competition policy. A new Competition Law was adopted in September 2015, after consultations with domestic and international stakeholders, including the World Bank, the EU and the AfDB. The new Law achieved some progress: (a) the mandate of the Competition Council has been strengthened (e.g., with respect to compliance review of legislation); (b) the transparency of the decision-making of the Competition Council and the Ministry of Commerce has been improved (although the publication of competition decisions should be mandatory); (c) the exemption criteria have been redefined, in line with EU best practice; (d) engagement in targeted economic analysis has been made possible to motivate decision-making; (e) leniency for whistleblowers in cartel cases has been introduced; (f) the review processes have been streamlined; and (g) provisions for sanctions have been strengthened.

43. To enhance the effectiveness of the competition legal framework, the Council of Ministers has adopted four implementing decrees of the 2015 Competition Law. The four decrees cover:

- *Procedures and modalities of obligatory consultations with the Competition Council on draft laws and decrees*, which are expected to strengthen the Council's standing vis-à-vis sectorial regulators and line ministries and help embed competition principles in sector policies more systematically;
- *Procedures for exempting agreements that are justified based on economic or technical progress*. These agreements are expected to promote efficiency-enhancing activities that are unlikely to restrict competition in a harmful way. At the same time, clear exemption procedures will help the Competition Council focus its resources on combating hard-core cartels;
- *Guidelines increasing the threshold for merger notification.* These will help reduce the costs to the private sector when engaging in merger transactions, especially when mergers are small in size and unlikely to have anticompetitive effects in the markets. The guidelines will also help reduce the administrative costs to the Competition Council/Ministry of Commerce of reviewing mergers not likely to cause harmful effects; and
- *Leniency application procedures* that will enhance transparency of the leniency process and encourage cartel detection through immunity from fines for companies that participate in cartel agreements and decide to cooperate with the Competition Council.

44. *Expected results:* The adoption of these four decrees will strengthen implementation of the Competition Law and promote the opening of markets and the sanctioning of harmful anticompetitive behavior. This reform seeks to improve the level of competition between private and public enterprises in these sectors and its outcome will be measured by the number of anticompetitive cases prevented or eliminated.

45. *Future steps:* To strengthen the competition framework, the Government needs to revisit the state's participation in certain economic activities. The state has a subsidiary duty to perform tasks only where private supply is not feasible. In this sense, SOEs should not replace or interfere in any manner with private businesses when they are fully capable of meeting a particular social need. A subsidiarity assessment enables the Government to evaluate the opportunity cost of funding an SOE and guarantees that scarce public resources are directed to services more valuable or necessary for citizens, such as education or infrastructure. The competition advocacy mandate of the Competition Council may involve scrutiny of those markets where SOEs are present, and of the structural conditions (including barriers to entry) in those markets that facilitate market power for SOEs. Such an assessment will help inform policy on the extent of state involvement in economic activities from a competition perspective.

46. Building on the rationale and policy reform related to the competition framework, the analysis will help identify key sectors where public enterprises play an important role, and ways to improve the level of competition between private and public enterprises in these sectors. The subsidiarity analysis can be used as an entry point for such work. Other reforms to increase competition, especially in backbone services, will also be explored.

47. *Political economy:* Competition and SOE reforms are challenging and need to be approached with care. A political economy analysis would help to identify economic actors and

social groups that may oppose the downscaling of government support to SOEs, and possible strategies to secure their buy-in. The discussion will continue with Government stakeholders, including the Ministry of Industry and Commerce, the Competition Council and others to agree on sectors covered in the analysis, and the methodology and timeline. The analysis will complement the Bank's TA on SOE reform, which will also help identify concrete strategies for key sectors.

***Prior Action #2: The new Investment Law No. 2016-71 dated September 30, 2016, reinforcing the rights and guarantees of investors and market access regulation, and its implementing decree, Decree No. 2017-390 dated March 9, 2017, establishing the unit at the Ministry of Development, Investment and International Cooperation responsible for streamlining investment entry authorizations, have been published in the Official Gazette No. 82 dated October 7, 2016 and the Official Gazette No. 25 dated March 28, 2017, respectively.***

48. *Rationale:* The Investment Incentives Code, developed in 1993 and amended several times, adds to the inefficiency of the investment framework in several ways. The Code focuses only on incentives, at a time when it should also cover legal guarantees for investors, market access regulations, and the institutional setup governing the investment framework. Market access remains restricted in many sectors, with unclear regulations and limits on foreign investment in some sectors imposing important distortions on the investment climate.

49. *Policy reform:* After several reform attempts since 2012, the Parliament has adopted a new Investment Law in September 2016. The key positive features of the new law are:

- A shift from a law focused only on listing incentives and their granting modalities, to a law that covers a general investment framework and affirms the rights and guarantees to investors in a clear single text. The text includes clauses related to national treatment, expropriation, repatriation and dispute settlement. These guarantees were absent from the previous Investment Code, and dispersed in various bilateral/regional agreements;
- The separation between fiscal and financial incentives, in line with international best practices. The Investment Law focuses on financial incentives, while tax incentives are now detailed in separate tax legislation;
- Adoption of the "silence is approval" principle, and the obligation to state in writing reasons for refusing authorization, thus improving efficiency and reducing discretion;
- Improved foreign recruitment rules for expatriate managers, entailing liberalization, and allowing to import of know-how when necessary;
- Special status designation of the new investment authority, allowing for more flexibility in management procedures, and the ability to attract better talent;
- Clearer rules for market access by: (a) abolishing the *Commission Superieure d'Investissement*, thus limiting discretion; (b) eliminating the list of activities subject to authorization for both local and foreign investors (Annex 1 of the old Investment Incentives Code); and (c) scrapping the list of activities that require authorization if foreign ownership exceeds 49 percent (Annex 2 of the old Code), thus providing equal treatment for local and foreign investors in those activities.

50. *Expected results:* The adoption of the new Investment Law and its implementing decrees will help create an investment framework that is more transparent and effective. The following

information and documents will be published and accessible on the website of the Ministry of Development, Investment and International Cooperation (MDICI): (a) the list of activities subject to investment entry authorization, the deadlines, procedures and the terms and conditions for their granting; and (b) the draft report on consultations as well as the final report on the recommendations and concrete proposals for streamlining investment entry authorizations. The new Law will encourage local and foreign investment generation in key sectors that can create durable advantages for the economy. It will also help to reduce market distortions and improve competition. It is expected that this reform will help encourage greater private sector participation in the economy.

51. *Future steps:* The new Investment Law still needs significant improvement in some areas, especially in relation to streamlining market access regulations and improving the institutional framework. In terms of improving market access, more than 100 economic activities are still subject to either authorizations or cahiers de charge, which are governed by sector-specific legislation or lower-level regulations beyond the scope of the Law. The Law's implementing decree starts the reform process by creating a unit responsible for reviewing and/or eliminating authorizations and converting them when possible to *cahiers de charge* subject only to ex-post review. The Government is committed to simplifying or eliminating a first wave of authorizations/*cahiers de charge* during the first year of the Law's operation.

52. *Political economy:* The new Law is a step forward, but its initial aims have been reduced in an effort to accommodate different interests. Technical assistance is being provided by the IFC to support an incremental approach to reform. Such TA is necessary to support reform efforts and address problems in the institutional framework.

***Prior action #3: The Decree No. 2017-394 dated March 29, 2017, establishing a unified public investment management framework for public investment projects (PIP) and public private partnership (PPP) projects to cover the appraisal, selection and prioritization, financing modalities and continuous monitoring of all investment projects has been published in the Official Gazette No. 26 dated March 31, 2017.***

53. *Rationale*: Public investment can be an important catalyst for economic growth and jobs by improving service delivery to firms and citizens and linking them to opportunities. But the benefit of additional investment depends crucially on its efficiency. A recent study estimates that the average country loses about 30 percent of the value of its investment to inefficiencies in public investment processes.[8] Improvements in public investment management (PIM) can help countries close up to two-thirds of that efficiency gap, with substantial growth and jobs dividends. There are concerns in Tunisia about the quality of public investment and its real impact on economic growth despite the fact that, in recent years, the management of public investment has kept pace with broader changes in public financial management (PFM). The old approach of dual budgeting was abandoned in favor of a more integrated approach in which investment became increasingly delegated to ministries, departments, independent budget agencies and local governments (governorates). Although initially successful, this response ended up downplaying the strategic importance of public investment to the economy, exposing long-term and costly decisions – characteristic of many large infrastructure projects – to shorter-

[8] IMF, 2015. "Making Public Investment More Efficient," Working paper, Fiscal Affairs Department.

term political whims, and ultimately threatening service delivery and growth. This has resulted in many projects being erroneously selected, in repeated cost overruns and implementation delays, in poorly finished outputs, in confusion and the duplication of roles, responsibilities and processes.

54. A greater private sector participation of in the provision of infrastructure and services, as promoted in the "cascade approach" for instance, can help Tunisia increase the efficiency of its public investment and deliver substantial savings and improvements in quality. In addition, the ongoing infrastructure assessment in the Maghreb region will also provide insights into the policy, legal and regulatory challenges that will need to be undertaken to facilitate greater private sector participation in infrastructure.

55. *Policy reform:* The Government is in the process of strengthening its framework for managing public investments in order to improve the efficiency and efficacy of capital expenditures and to effectively deliver its Five-Year Development Plan for 2016-2020. The new unified PIM framework establishes a public investment decision process for both PIP and PPP projects that covers the entire project cycle, from concept to pre-feasibility and feasibility studies, prioritization of capital investment (based on cost–benefit analysis and expenditure efficiency), financing modalities, continuous monitoring of the fiscal affordability of all projects, project execution, operation and ex-post evaluation. Rigorous project identification and selection mechanism prevent inappropriate and inefficient projects from getting into the project cycle and gaining support and momentum that make them difficult to stop at later stages. This reform will also allow the Government to unify the management of all public investments, including PPPs, following the approval of the PPP law (Law No. 2015-49 of November 27, 2015), and strengthen the pre-identification and pre-selection of PPP projects. This fits well into the "cascade approach" and its focus on enhanced efficiency and savings in public funds via private sector participation in infrastructure.

56. In addition, a draft project selection manual has been developed to assist officials involved in capital budget preparation in using project selection and prioritization criteria. The manual proposes criteria that will sharpen distinctions among projects, narrow the range of disagreement, and provide a basis for discussion with the aim of making the entire selection and prioritization process more transparent. The priority setting process will have the following characteristics: (a) it is understandable to all users of and stakeholders in the process; (b) it is practical in terms of cost, time and personnel available to carry it out; (c) it considers all major consequences of a project; (d) it is supported by reliable, relevant information; (e) it indicates clearly whether the key criteria and their weighting are to be made by technical experts or public officials; and (f) it identifies critical and non-critical projects according to national, sectoral and regional development objectives.

57. *Expected results*: The most significant challenge in Tunisia's current situation remains the achievement of a qualitative improvement in its public investments that can either be implemented as PIPs or PPPs. Through the implementation of this reform, the quality of projects is expected to improve in terms of pre-feasibility studies and cost-benefit analysis, execution and monitoring, and ex-post evaluation. The proposed results indicator is the share of investment projects for which a feasibility study, including a cost-benefit analysis, has been completed during the pre-investment phase. Beyond this indicator, it is expected that the reform

will (a) increase integration and prioritization of public investment with broader policy objectives; and (b) help the Government ensure that its investments promote welfare, growth and reduce inequalities and unemployment, and that fiscal risks are identified and well managed. In addition, the Government can mobilize private sector resources by applying the cascade approach, which uses risk-sharing to attract private investors, and by making greater use of PPPs.

58. *Future steps*: As a next step, the Government plans to develop an Integrated Bank of Projects (IBP) for which public financing, or public endorsement in the case of PPPs, is annually applied. This registry will support PIM by assigning a single, unambiguous identification number to each investment initiative for its entire lifecycle. The IBP will allow for: (a) a frequent assessment of project status and results, as all Basic Investment Statistics (BIS) files are updated regularly; (b) aggregate or specific analysis of public investments; and (c) ex-post evaluation of investment initiatives. The IBP will be rolled out in pilot sectors and governorates.

59. *Political economy:* The PIM framework and the project selection manual will be implemented gradually, and in an adaptive manner: they will first be piloted in selected sectors and then scaled up. A qualitative assessment will be embedded in the piloting phase to evaluate implementation of the framework and manual. It will look at how decision-making operates at different decision points in the PIM process, and the capacity of existing institutions to absorb new processes and rules. The analysis will help identify potential institutional gaps and political interference in the PIM decision process, and ways to incentivize behavior change to increase transparency and accountability in decision-making. The results will inform the scaling up of the PIM framework, and ensure that the development of the new PIM framework and manual results in a shift away from costly and inefficient public investment practices.

***Prior Action #4: The Minister of Finance and the Minister of Transport have issued Circular No. 86 dated November 14, 2016, replacing Circular No. 19 dated March 30, 2011, to introduce the digitization of remaining port procedures. Circular No. 86 has been published on the website of the Ministry of Finance.***

60. *Rationale:* Streamlining trade and transport procedures plays an important role in improving the business environment. About 95 percent of containers go through the Port of Radès, which is consistently identified as a source of delays and lack of competitiveness by firms.9 Delays and productivity indicators at the port have further worsened recently. The average dwell time10 reached 16.6 days in 2016, up from 10 days on average in 2010.[11] Dwell time, which is a good proxy for logistics efficiency, is around three to four days in middle-income countries. The worsening of the delays since 2011 is due to various factors including poor maintenance and repair of critical machinery, union strikes and protests by personnel of *Societe Tunisienne d'Acconage et de Manutention* (STAM), a public company, which has a monopoly on container operations at Radès.

[9] World Bank 2014.
[10] Port dwell time refers to the time cargo (containers) spends within the port or its extension.
[11] Ministry of Transport data:
http://www.transport.tn/uploads/Statistique/Les_indicateurs_performance_2016_fr.pdf

61. One of the main difficulties in the Port of Radès in the lack of clear accountability for clearance procedures, from ship arrival to the exit of containers from the port. There are several sources of delays that are not well captured in the current system. One is the time the operator takes to declare its container after its arrival in the port. Another is the time taken to remove goods from the port after their release by customs. According to the latest figures, more than 40 percent of containers remain in the port after customs releases them. This lack of critical information prevents the Government and private operators from clearly identifying the roles and responsibilities of respective players. It also translates into a negative environment between operators and government agencies, as well as among various government agencies operating in the port.

62. *Policy reform:* This action aims at enhancing the flow of information into the Tunisia Trade Net (TTN) platform. TTN manages a data-processing network and connects the various foreign trade operators (traders, freight forwarders, customs, and banks) in Tunisia. TTN's mandate is to facilitate the procedures for foreign trade to ensure the traceability of containers and reduce their dwell time at ports. The Ministry of Finance and Ministry of Transport approved Circular 86 on November 19, 2016 which amends Circular 19 dated March 30, 2011, making the electronic notice of arrival of merchandise mandatory rather than optional. The new Circular also specifies the information to be included in the advance cargo manifest so that customs and port authorities can easily identify the owners of containers that are unloaded. The Ministry of Transport is also implementing a number of complementary reforms such as extending the work day to 24 hours and introducing GPS tracking of containers within the port premises.

63. *Expected results*: This prior action is expected to translate into a reduction in the dwell time from 16.6 days to 12 days by end-2018,[12] by clarifying the roles and responsibilities of all operators connected to TTN. It will also lead to faster removal of containers from the port, freeing space and reducing congestion and costs for importers and exporters, including hovering costs, which can reach TND 7,000-8,000 per day.

64. *Future steps:* TTN is implementing a number of reforms and system improvements, with the aim of achieving a comprehensive monitoring and alert system over the next two years. These improvements range from software development to allow for electronic signature, to supporting the development of online platforms linked to TTN by other agencies. Building on this information base, the ministries – in collaboration with other stakeholders (logistics firms, importing and exporting firms, banks) – will complete and publish on their websites an evaluation of the time consumed by all port and trade procedures, with benchmark reduction targets.

65. *Political economy:* The Ministry of Transport has also embarked on a range of reforms to improve the traceability of containers as they move through the port. For example, the Smart Gate System automates security functions, authenticating the identity of the driver, vehicle and cargo. This automation of operational functions reduces or eliminates the need for human

[12] Other parallel reforms are currently envisaged by the Ministry of Transport, STAM, Customs Authority and other entities to reduce contained dwell time that are adding to the expected results of this reform.

intervention. Consultations with unions will be ongoing to share information with them and ensure their buy-in, and the new procedures will be rolled out gradually. Port employees are not expected to oppose this reform.

**Supporting entrepreneurship and deepening access to finance**

***Prior action #5: The Council of Ministers has approved on April 28, 2017, and the Head of Government has transmitted to Parliament on May 2, 2017, the draft Code for Seed and Equity Capital (Code des Organismes d'Investissment Collectif) enhancing access to finance of young firms and entrepreneurs.***

66. *Rationale:* Entrepreneurs in the knowledge economy can face several years of zero or marginal sales. In those years, expenses are covered with equity and quasi-equity capital provided by specialist funds. In Tunisia, non-debt financing of entrepreneurs falls under a framework designed to protect small investors. This framework is costly, as it involves extensive disclosures, governance requirements, transparency around corporate events, communication with investors, and regulatory approval for fundraising. Sophisticated investors specializing in financing young entrepreneurs (and funds in which they invest) demand less regulatory burden in exchange for less protection from the regulator. Despite the constraining framework, ATIC (the Tunisian association of capital investors) reports that 2015 saw investments of TND 200 million in young or high-growth SMEs, half of which were in lagging regions. The new companies created 200 direct jobs.

67. *Policy reform:* The Ministry of Finance and the capital market authority (*Conseil des Marchés Financiers*, CMF) have consulted widely across ministries and ATIC membership, with Bank support. This coalition has finalized a new Seed and Equity Code that cuts the regulatory burden on sophisticated investors and introduces new financial vehicles and corporate forms that have become standard in the international practice of financing high-growth MSMEs.

68. *Expected results:* The new Code will help finance Tunisia's knowledge economy and boost job creation for STEM graduates, including women, with an increased number of funds or managers specializing in equity financing of MSMEs. The Government aims to boost seed and equity capital raised from investors from TND 200 million per year, on average, in 2012-2015 to TND 300 million per year in 2017-2018.

69. *Future steps*: Tunisia's public mechanisms for financing MSMEs are under-performing. There is a juxtaposition of institutions, multiple reporting lines and no overall monitoring. *Banque de Financement des PME* (BFPME), *Société Tunisienne de Garantie* (SOTUGAR) and *Banque Tunisienne de Solidarité* (BTS) are slow and difficult to navigate for MSMEs. Consolidating and rationalizing Tunisia's public mechanisms is overdue. The Ministry of Finance, with support from KfW, has finalized a diagnostic of existing public mechanisms and developed several scenarios, including consolidating the mechanisms that provide credits and guarantees to MSMEs. A rationalized mechanism for leveraging the resources of the banking sector would deliver greater access to finance for MSMEs, including in lagging regions. It is expected that the number of MSMEs benefitting from public support would increase by 10 percent over the program period.

70. *Political economy:* There are no known opponents to the Seed and Equity Code. The Ministry of Justice which would need to amend the Corporate Code to allow for less expensive forms of incorporation and for new financial contracts such as stock options, preferred shares and convertibles notes. With respect to consolidating public mechanisms, the transition to a new system requires a strong human resource and communication strategy to ensure buy-in from staff of existing institutions. However, the number of staff in existing institutions is small and their skills are attractive to the private sector.

***Prior Action #6: The Council of Ministers has approved on February 24, 2017 and the Head of Government has transmitted to Parliament on February 27, 2017 the draft Law (Loi organique) on Credit Bureau improving credit information and promoting access to credit for young MSMEs and entrepreneurs.***

71. *Rationale:* Credit bureaus (CBs) produce and synthesize information about borrowers' ability to meet their obligations under loan contracts. CBs allow credit institutions to increase credit to individuals and MSMEs, while improving risk management. Under certain conditions, CBs also facilitate new credit to the informal sector by acquiring and processing information on an individual's performance under standardized non-loan contracts such as utility payments. Credit scoring stimulates competition between banks and other suppliers of credit.

72. *Policy reform:* An organic law is needed for CBs to operate legally in Tunisia—the 2004 Law on Protection of Personal Data appears insufficient. The proposed draft Law on Credit Bureaus directs the Central Bank to develop implementing regulations that set minimum requirements and obligations for CBs regarding, for example, protection of confidential data and continuity of service.

73. *Expected results:* It is expected that the Central Bank will issue at least one license to operate a CB. The license requires the CB to offer SME credit scoring within two years of operation. The reform will contribute to renewal of the social contract through more inclusive and sustainable access to credit for: (a) SMEs, including women-owned SMEs, (b) the self-employed, and (c) the housing needs of low-income populations. For established borrowers, CB information translates into less demanding loan guarantees, better rates and loans of longer maturity. Such information also helps banks and microfinance institutions extend loans to new borrowers, notably women in lagging regions, and brings more informal activity into the formal economy.

74. *Political economy:* Reporting to the CB will be each bank's commercial decision. The Bank supports the Government in formulating a financial inclusion strategy for 2017-2021, a component of which would be a financial inclusion law that would allay legal concerns.

***Prior Action #7: The Law of Collective Procedures No. 2016-36 dated April 29, 2016, simplifying Tunisia's bankruptcy regime has been published in the Official Gazette No. 38 dated May 10, 2016.***

75. *Rationale:* Two laws were dealing with restructuring and bankruptcy in Tunisia, resulting in a fragmented and outdated bankruptcy regime, with duplicate and cumbersome processes for both business rescue and exit, leaving a marginal role for creditors. The main

problems in this insolvency regime include (a) heavy penalties, even for non-criminal activities; (b) stigma associated with bankruptcy; (c) the requirement for all cases, even straight liquidation, to go through judicial proceedings (*règlement judiciaire*), which drains money from the estate; (d) the quasi-judicial role of the *Commission de Suivi des Entreprises* (Business Monitoring Commission, CSEE), which hampers pre-insolvency rescue; (e) the lack of confidential out-of-court procedures, which makes debtor businesses reluctant to file for amicable settlement; (f) limits on creditors' right to vote on restructuring plans; and (g) giving priority to the Treasury's tax claims in the distribution of proceeds, minimizing creditor recovery. The reform is of particular importance for Tunisia, given the high levels of NPLs, economic stagnation, and banks' reluctance to lend to MSMEs.

76. *Policy reform:* To simplify business exit procedures and strengthen the credit environment, the Government is modernizing Tunisia's bankruptcy regime and has finalized a new unified Law of Collective Procedures, which merges Chapter IV of the Commerce Law and Law No. 95-34. The new Law, supporting the following key measures,[13] was adopted by Parliament in April 2016:

- *Improved efficiency and flexibility*. Bankruptcy procedures are greatly simplified; assets can be sold to preserve a going concern; time limits are placed on debt rescheduling; liquidation is allowed if the business is in "desperate condition"; duplicate creditor arrangements *(concordat préventif)* are removed; the role of CSEE is reduced to ensure greater impartiality and objectivity in the proceedings.
- *A culture of business rescue*: The emphasis on bankruptcy as a crime is much reduced; creditors have a new money privilege; the judicial settlement provisions are modified to encourage entrepreneurship while maintaining sanctions for bad faith debtors (although certain restrictions persist on creditors' ability to assume management role). Most importantly, a type of cram-down process has been introduced (although with caveats) overhauling the role of creditors in insolvency procedures and encouraging them to save viable businesses by allowing them to vote on a restructuring plan and have this plan crammed down with majority consensus. The Law also introduces a cap on state privilege in terms of the distribution of proceeds in case of liquidation.

77. *Expected results:* A more predictable, transparent and efficient bankruptcy regime improves the confidence of creditors. It provides support to entrepreneurship, giving a second chance and decriminalizing bankruptcy. It helps retain employment in viable businesses. It encourages information production and sharing, which allows financial institutions to price risk more accurately. Moreover, the new insolvency regime should facilitate exit and re-entry of entrepreneurs, allowing a more efficient allocation of resources toward productive assets. Research suggests that insolvency reforms tend to increase returns to creditors. The results indicator will be the number of cases initiated under the new Law.

78. *Future steps*: The Government will need to draft the Law's executive regulations and review the regulatory framework that governs insolvency practitioners. The Government will also need to build the capacity of judges and insolvency practitioners. In parallel to court

[13] The Law could have benefited from further improvement, such as limitation in introducing a "haircut" on principal, more clarity on voting in case of cram-down, and ranking of secured creditors inferior to the state in case of liquidation.

proceedings, the Government and the Central Bank could support the introduction of lighter-touch tools, such as out-of-court workouts.

***Prior action #8: To improve households' access to housing finance, the Decree No. 2016-1126 dated August 18, 2016, revising the eligibility criteria of the Social Housing Promotion Fund (FOPROLOS or Fonds de Promotion du Logement pour les Salariés) has been published in the Official Gazette No. 71 dated August 30, 2016.***

79. *Rationale:* Despite sizeable mortgage lending (17 percent of GDP), only 4 percent of households have a housing loan.[14] Banks are reluctant to lend to low-income or non-salaried borrowers. Since 1974, FOPROLOS has provided mortgages to salaried workers who earn up to 4.5 times the minimum wage, for the purchase of a new home costing less than TND 85,000. FOPROLOS mortgages are financed by a contribution of one percent of wages. FOPROLOS mortgages are advantageous: 25-year maturity; grace period up to three years; fixed rate of 2.5 to 5.75 percent, depending on the borrower's income bracket. Notwithstanding these advantages and its notional cash-on-hand of TND 600 million in 2015, FOPROLOS lent out only TND 13 million to 303 households in 2015. This poor uptake reflects out-of-date eligibility criteria: (a) only salaried applicants, although the non-salaried population has become much larger since 1974 (one-third of non-farm employment, 430,000 households) and includes creditworthy households (average estimated household income of 2.5 times minimum wage); (b) the disconnect between the fund's ceilings on eligible homes and market prices; and (c) the exclusion of self-construction, the main supply of affordable housing, particularly in lagging regions. Other weaknesses include: (a) FOPROLOS loans are distributed exclusively by Banque de l'Habitat (BH, Housing Bank); (b) credit decisions are centralized at the Ministry of Housing; (c) there is limited room for BH to restructure distressed loans, resulting in 25 percent NPLs; and (d) FOPROLOS resources do not leverage BH own resources, e.g., through the use of guarantees.

80. *Policy reform:* The decree has revised eligibility criteria: (a) higher prices for eligible homes; and (b) authorization for self-construction and small land acquisition (subject to conditions). The Bank supports follow-up work for a more comprehensive reform of FOPROLOS.

81. *Expected results:* The reform would expand access to housing finance (for purchase and improvements) for low and middle-income workers, thus significantly improving their living conditions. The Government aims to increase the number of FOPROLOS loans per year from 286 on average in 2013-15 to 600 by end-2018. The wider availability of housing finance will also enable households to build the equity and collateral needed to mobilize financing for income-generating activities, such as starting and investing in a small business. Over time, the additional housing investments generated by the reform will support job creation in and around construction and related value chains, typical activities where MSMEs flourish.

82. *Future steps*: These will include opening up the distribution of FOPROLOS loans to all banks; delegating decision-making to banks, except in borderline cases, with suitable accountability; introducing a grant element to improve the solvency of lowest-income

[14] Access to housing loans varies with income: 0.5 percent for the poorest decile; 9.6 percent for the wealthiest decile.

households and a guarantee element to leverage the resources of banks; and developing a product dedicated to the housing finance needs of non-salaried households. Further reforms will be needed to extend the reach of the FOPROLOS and address some of the remaining causes of low uptake. Such reforms might be more politically contentious. In particular, the fund is currently solely distributed by BH, to the exclusion of other banks that may have interest in the low-income housing finance segment. Opening the fund to such banks could possibly generate resistance from the BH. The Bank's ongoing technical assistance can help mitigate this potential risk.

83. *Political economy:* This reform measure has been adopted with no major resistance from the stakeholders involved, and its implementation began in January 2017. Support for this reform is arguably linked to its positive dividends for the renewal of the social contract: the Government is eager to deliver results in this area, as it recognizes the importance of housing for social stability and people's well-being. The sector's importance also lies in its potential for job creation (particularly low-skilled jobs). Positive communication around this measure that highlights its pro-poor nature and potential for job creation could have a positive impact on the broader reform efforts.

**Analytical underpinnings**

84. **The proposed DPL builds on the work undertaken as part of the Tunisia Development Policy Review (DPR) and the SCD, as well as technical assistance activities and regional and global analytical reports.** The Tunisia DPR and SCD provide the analytical underpinning for most of the reforms supported by the proposed DPL. The SCD identifies macroeconomic and fiscal stability as a pre-requisite for growth and job creation, and for achieving the twin goals of eradicating extreme poverty and promoting shared prosperity in a sustainable manner. The DPR and SCD argue that the Tunisian economy failed to generate sufficient good quality jobs because it is burdened by a system of rents and privileges that thrives on the pervasive web of regulations and restrictions. This system stifles competition and protects privileged firms, obstructing the development of a dynamic economic environment. The World Bank regional report Jobs or Privileges[15] provides evidence that in this context entrepreneurship is constrained, with very few firms entering the market every year and the majority of new entrants remaining small or exiting after three to five years of existence. The DPR and the SCD recommend actions to remove rents, increase competition, open the economy and promote entrepreneurship. Several technical assistance activities have also been delivered or are ongoing to diagnose the existing institutional and legal framework, and design and calibrate the reforms (e.g., debt management, institutional framework and incentives for investment, insurance market, housing finance).

[15] World Bank MENA Regional Report:, 2015 "Jobs or Privileges – Unleashing the Employment Potential of the Middle East and North Africa."

## Table 4: DPL Prior Actions and Analytical Underpinnings

| Prior actions | Analytical Underpinnings<br>(be specific about the finding informing the prior |
|---|---|
| **Improving the business environment** | |
| Prior action #1: The four implementing decrees of the new Competition Law No. 2015-36 dated September 15, 2015-Decree No. 2016-780 dated June 13, 2016, Decree No. 2016-1148 dated August 19, 2016. Decree No. 2016-1204 dated October 18, 2016, and Decree No. 2017-252 dated February 8, 2017- have been published in the Official Gazette No. 51 dated June 24, 2016, the Official Gazette No. 72 dated September 2, 2016, the Official Gazette No. 87 dated October 25, 2016, and the Official Gazette No. 13 dated February 14, 2017, respectively. | Development Policy Review: World Bank (May 2014), *The Unfinished Revolution. Bringing Opportunity, Good Jobs and Greater Wealth to All Tunisians;* Report No. 86179-TN; and associated background papers.<br><br>World Bank, Tunisia Investment climate assessment, February 2014. |
| Prior action #2: The new Investment Law No. 2016-71 dated September 30, 2016, reinforcing the rights and guarantees of investors and market access regulation, and its implementing decree, Decree No. 2017-390 dated March 9, 2017, establishing the unit at the Ministry of Development, Investment and International Cooperation responsible for streamlining investment entry authorizations, have been published in the Official Gazette No. 82 dated October 7, 2016 and the Official Gazette No. 25 dated March 28, 2017, respectively. | Development Policy Review: World Bank (May 2014), *The Unfinished Revolution. Bringing Opportunity, Good Jobs and Greater Wealth to All Tunisians;* Report No. 86179-TN; and associated background papers.<br><br>IFC TA on Investment Law |
| Prior action #3: The Decree No. 2017-394 dated March 29, 2017 establishing a unified public investment management framework for public investment projects (PIP) and public private partnership (PPP) projects to cover the appraisal, selection and prioritization, financing modalities and continuous monitoring of all investment projects has been published in the Official Gazette No. 26 dated March 31, 2017. | *Tunisia: Strengthening of Public Financial Management* (Aide-Memoire, February 2016).<br><br>World Bank technical assistance reports on public investment management. |
| Prior action #4: The Minister of Finance and the Minister of Transport have issued Circular No. 86 dated November 14, 2016, replacing Circular No. 19 dated March 30, 2011, to introduce the digitization of remaining port procedures. Circular No. 86 has been published on the website of the Ministry of Finance. | World Bank, Tunisia: *Advancing Tunisia's Global Integration*, June 2014.<br><br>Djankov, Freund, and Pham, 2006, *Trading on Time*, World Bank Policy Research Working Paper 3909, May 2006.<br><br>Private Sector Consultations Report by IACE, 2014.<br><br>ISTIS and IACE Compliance Cost Savings Surveys, 2013 and 2015. |
| **Supporting Entrepreneurship and Deepening Access to Finance** | |

| | |
|---|---|
| Prior action #5: The Council of Ministers has approved on April 28, 2017, and the Head of Government has transmitted to Parliament on May 2, 2017, the draft Code for Seed and Equity Capital (*Code des Organismes d'Investissment Collectif*) enhancing access to finance of young firms and entrepreneurs. | World Bank technical assistance report |
| Prior action #6: The Council of Ministers has approved on February 24, 2017 and the Head of Government has transmitted to Parliament on February 27, 2017 the draft Law (*loi organique*) on Credit Bureau improving credit information and promoting access to credit for young MSMEs and entrepreneurs. | Capacity building program delivered by IFC |
| Prior action #7: The new Law of Collective Procedures No. 2016-36 dated April 29, 2016, simplifying Tunisia's bankruptcy regime has been published in the Official Gazette No. 38 dated May 10 2016. | Development Policy Review: World Bank (May 2014), *The Unfinished Revolution. Bringing Opportunity, Good Jobs and Greater Wealth to All Tunisians;* Report No. 86179-TN; and associated background papers.<br><br>Tunisia: *Financial Sector Assessment Program Update* (Aide-Memoire, November 2012). |
| Prior action #8: To improve households' access to housing finance, the Decree No. 2016-1126 dated August 18, 2016, revising the eligibility criteria of the Social Housing Promotion Fund (*FOPROLOS or Fonds de Promotion du Logement pour les Salariés*) has been published in the Official Gazette No. 71 dated August 30, 2016. | MENA Transition Fund technical assistance project supported the evaluation of existing housing finance support mechanisms and reform recommendations to improve access to housing finance for low income households (World Bank). |

## 4.3 LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

85. **The proposed operation is fully aligned with the World Bank Group (WBG) strategic goals to eliminate extreme poverty and boost shared prosperity in a sustainable manner, as well as with the MNA Regional Strategy and the Country Partnership Framework for Tunisia 2016-2020.** By supporting stronger and more inclusive growth and job creation, in particular through entrepreneurship, this DPL will promote the WBG's overarching objectives. This DPL is also consistent with the WBG MNA Strategy's objectives of tackling the underlying causes and remedying the consequences of conflict and social tension. Specifically, the proposed operation would contribute to *renewing the social contract* pillar, as the supported policy measures will strengthen the business environment and competition framework, improve financial and business services to entrepreneurs, and promote greater access to finance. Finally, this operation is fully aligned with the WBG Tunisia CPF 2016-2020, in particular with its first pillar by improving the enabling environment for private sector competitiveness (CPF objective 1.2) and the third pillar on promoting increased social inclusion.

86. **The IFC together with the Bank have played an important role in providing technical assistance linked to the two DPL pillars.** Key prior actions and reforms supported by IFC TA are on competition, investment framework, bankruptcy and business exit regulations and credit bureaus.

87. **The policies supported by this operation are complemented by the ongoing Bank-financed investment projects and activities aimed to stimulate entrepreneurship and improve economic opportunities particularly for women and in lagging regions.** These include a series of recent hackathon events for women's economic empowerment (see Box 3), value chain development activities aimed to help Tunisia move up the value chain and link Tunisian entrepreneurs to these higher value added products and markets, and support economic inclusion for poor and vulnerable women and youth in lagging areas.

**Box 3. Applying the hackathon model to promote women's economic empowerment and entrepreneurship in lagging regions**

***The hackathon model consists of quick events for developing prototypes of technological tools to tackle development problems and has been utilized effectively in many parts of the world.*** The hackathon is a time and cost effective way of developing creative technology solutions and is a natural method of engaging young and innovative population to address long-standing development challenges. In a hackathon, the World Bank leverages its convening power to bring together the necessary experts and stakeholders in the government and civil society to define specific local challenges, and engages local volunteer technologists to rapidly develop prototype solutions to those challenges.

***The WBG organized a series of hackathon events in Morocco and Tunisia between February and March 2017 aimed at promoting women's economic empowerment and entrepreneurship in lagging regions***. The objective of the hackathons was to find solutions to address the constraints to women's labor force participation and entrepreneurship in Morocco and Tunisia's lagging regions. These hackathons support the implementation of the World Bank's Gender Strategy (2016-23) as well as the MENA regional gender action plan which aims to remove constraints to more and better jobs for women. These events are also strongly linked to the implementation of the new Tunisia CPF (pillar 2 on "Reducing Regional Disparities" and pillar 3 on "Social Inclusion") and to the new focus of the Morocco CPS on the issues of youth, women's economic empowerment, employment and education.

***Early results of the hackathon were presented to the World Bank's Advisory Council on Gender at the IMF-WBG Spring Meetings 2017. The lessons learned from the hackathon will inform the pipeline projects on economic inclusion, entrepreneurship and youth in lagging regions.*** Solutions developed during the hackathon events include :(i) applications (apps.) for mentoring and training rural women to create their own projects and become entrepreneurs, with an application that also allows them to market their own products in addition to training capabilities. This app includes voice-activated training solutions for the illiterate women; (ii) apps to provide more information on entrepreneurship opportunities (including access to finance); (iii) apps. to facilitate the purchase of raw material at lower cost; (iv) peer-to-peer mentoring apps. for unemployed graduates; etc. This hackathon initiate did not stop at the application conception stage but includes a follow-up phase that supports the winners in their project implementation to make sure that the women of the lagging regions get the benefits of these solutions.

## 4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

88. **The Government has consulted broadly on the prior actions supported by the BEE DPL.** The main areas of reform are explicitly referred to in the *Note d'Orientation Strategique* issued by the Government in 2015 and the *Five-Year Development Plan 2016-2020* approved by Parliament on April 12, 2017. Further consultations have taken place during the preparation of the proposed operation, targeting public sector officials, civil society and the private sector. The Government has notably engaged in various consultations with the private sector, on

specific reforms such as regulatory simplification, investment code reform and support to entrepreneurship.

89. **In addition, the Bank regularly undertakes consultations with key civil society organizations on the reform program and its analytical underpinnings.** These consultations confirm that the content of the program generally enjoys broad support, as the reforms are deemed essential for Tunisia's economic transformation. Issues not directly targeted by the program but often raised as critical include regional development, fighting contraband, and basic education reform. The Bank continues to have excellent collaboration with the European Union (EU), the African Development Bank (AfDB), as well as United Nations agencies and other bilateral partners such as the AFD and the Japan International Cooperation Agency (JICA), all of whom have a strong local presence in Tunisia.

## 5. OTHER DESIGN AND APPRAISAL ISSUES

### 5.1 POVERTY AND SOCIAL IMPACT

90. **The policies supported by this operation are not expected to have negative poverty and social impacts.** The investment climate and competition measures are expected to yield direct benefits in terms of consumer welfare, improved competitiveness of Tunisian companies, and increased attractiveness for investors. The effect of greater competition on net job creation could be negative in the very short term as less competitive firms shed jobs but additional jobs created by new entrants and more productive firms could dominate this effect especially in the medium-term. Improved allocation (equity) and efficiency of public investment will have positive impact on the reduction of poverty and inequality. A gender-neutral expansion in essential infrastructure and services will likely disproportionately benefit women and girls, and help address existing gender gaps in access to health and education.

91. Greater availability of financing for entrepreneurship will improve job creation through the creation of new firms and the survival and growth of existing young firms. The establishment of private credit bureau will enhance lenders' risk assessment and contribute to lowering possible adverse effects related to the risk of household and individual over-indebtedness. Greater access to financing for young firms and entrepreneurs will improve women's economic opportunities and empowerment especially when combined with specific actions and investments on the ground such as those highlighted above (hackathon, value-chain activities and investments, economic inclusion and jobs projects). For more detail, please see Annex 5.

### 5.2 ENVIRONMENTAL ASPECTS

92. **Over the last years, Tunisia has confirmed a consistent, high level, and long-term commitment for environment protection.** The Tunisian Constitution explicitly addresses the need to safeguard a healthy environment and to tackle climate change. The Government's *Note d'Orientation Stratégique* which outlines Tunisia's development vision for the next five years consists of five pillars, with the fifth one dedicated to promoting green growth for sustainable development. The 2016-2020 Five-Year Development Plan tackles several critical challenges, including the implementation of key aspects of sustainable development, to provide a balanced

territorial development and integrate all regions, while respecting the environment. The implementation of the action plan depends on a rational use of natural resources, better environmental protection, and greater control on energy consumption.

93. **The implementation of the policy actions supported by the proposed DPL is not likely to have significant impact on the environment, forests, and natural resources.** However, if negative environmental impacts were to result from the DPL-supported reforms, Tunisia has strong and well-defined institutional, legal and regulatory frameworks concerning the management of social and environmental impacts of investments. According to the national Environmental Impact Assessment (EIA) system, all activities likely to have a significant effect on the environment are subject to an environmental impact assessment which must take place before licensing and investing activities. EIA is mandatory for any industrial, commercial or agricultural project, which could generate significant environmental impacts.

94. **The Ministry of Environment and Local Affairs (MELA) is the key player in the definition and implementation of environmental policies and strategies**. It proposes the policies related to the environment, ensures the coordination and monitoring of actions by the state and local authorities for the protection of nature and the environment, the fight against pollution and nuisances, and the improvement the quality of life. It publishes an annual report on the state of the environment, and action plans are implemented to address various environmental problems (on water, solid waste, biodiversity, natural resources, urban planning, etc.).

## 5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

95. **Addressing public sector governance and public financial management is identified as a key priority in the Tunisian Government's Five Year Development Plan 2016 - 2020.**The 2016 Public Expenditure and Financial Accountability assessment (PEFA)[16] found that the legal and administrative framework for public financial management offers a level of assurance regarding reliability of information, predictability and control in budget execution and a strong control environment; however the report also identified weaknesses related to budget comprehensiveness, transparency and accountability. To respond to these challenges, the Government continues to support strategic public sector governance and public financial management (PFM) reforms. These reforms include: (i) the implementation of the new Organic Budget Law aimed at improving the transparency, allocative efficiency and performance orientation of public expenditures and programs. The adoption by the Parliament of the draft Organic Budget Law is anchored in the IMF and EU programs[17]; (ii) the implementation of public sector accounting reforms; (iii) the implementation of tax administration and revenue management reforms aimed to improve the equity and efficiency of revenue collection and to create the fiscal space needed to finance the Government's ambitious development plan; (iv) the strengthening of Tunisia's public investment management in order to improve the efficiency and socio-economic impact of public investments while leveraging private financing and expertise at the central and sub-national level, especially in lagging regions; (v) the reform of the public sector to foster a more open, client-centric and performance-oriented public

[16] https://pefa.org/sites/default/files/TN-May16-PFMPR-Public%20with%20PEFA%20Check.pdf
[17] The Organic Budget Law was approved by the Council of Ministers in November 2015 and then submitted to the Parliament for review and adoption.

administration and public service delivery; (vi) strengthening public outreach and inclusive dialogue as part of strengthening public policy making, implementation and monitoring; and (vi) strengthening the oversight and governance of SOEs, which play a key role in the provision of core public services and financial management.

96. **Fiscal reporting has made notable progress[18], even if the quality of fiscal data needs to be improved through accounting reform. Reconciliations of banking and fiscal records are done satisfactorily on a monthly basis, facilitated by efficient computerization**. Financial control is ensured by effective and reliable control systems—both internal and external, as well as ex-ante and ex-post. Financial controllers, who are part of the Directorate-General of Financial Control (DGDP), carry out the ex-ante control of expenditure commitments and report to the Prime Minister's Office. The Court of Accounts carries out good quality external audit and the international audit standards on autonomy, scope and quality are met. The proposed budget and financial management reform program focuses on the implementation of sector MTEFs (which will be, in principle, framed by an aggregate MTFF and an MTEF that will frame the inter-sectoral resource allocation) and performance monitoring. It covers a range of PFM issues and includes a proposed training program, the implementation of a new budget classification, the finalization of the chart of accounts and the preparation of a new organic budget law.

97. **The first-time safeguards assessment of the Central Bank of Tunisia (BCT) undertaken in 2012 by the IMF in the context of the preparation of the SBA, found an adequate control environment for the day-to-day operations, but oversight, autonomy, and transparency need strengthening.** The BCT publishes its audited financial statements in a timely manner, but information disclosure should be enhanced. Action is needed to mitigate risks to the BCT balance sheet that would result from a significant increase in liquidity lending operations. Development of the internal audit function will need capacity building and oversight by the newly established Audit Committee. The BCT confirmed its commitment to implementing the recommendations of the safeguards assessment, some of which, such as the improvement of its collateral framework, were already part of its reform agenda. The statutory audit report on Central Bank financial statements covering calendar year 2015 has an unmodified audit opinion and no major deficiencies were identified by the external auditor.

98. **The proposed loan will follow the Bank's disbursement procedures for development policy financing.** Once the loan is approved by the WBG Board of Executive Directors and becomes effective, the proceeds of the loan will be disbursed in one tranche and in compliance with the stipulated release conditions as defined in the Loan Agreement and following GoT practices for receiving funds related to budget support (dedicated deposit account). At GoT's request, the proceeds of the loan will be first deposited by the IBRD into a

[18] Every budget, regular and supplemental is published in the official journal upon approval, and it is also made available on the Ministry of Finance web portal (for instance the 2014 budget and the 2013 supplementary budget are available at the following link: http://www.finances.gov.tn). Budgets since 2003 are available online. In line with the reforms supported by the GOJ-1 DPL, the Government is committed to further expand the publication of information related to the budget and public finances, including a more accessible "Citizen's budget".

dedicated deposit account[19], which forms part of the country's official foreign exchange reserves, nominated by the GoT and held at the BCT. Then, an equivalent amount in local currency will be credited to the single treasury account of the government to finance budgeted expenditures. The conversion will be based on the prevailing exchange rate on the date that the funds are credited to the Treasury Account. Within 30 days of disbursements the GoT will report, by written confirmation, to the Bank on the amounts deposited in the foreign currency account and credited to the budget management system**.** The confirmation will include the local currency amount credited to the account that is used to finance budgeted expenditures, the exchange rate applied and the date of the transfer. If the proceeds of the loan are used for ineligible purposes as defined in the Loan Agreement, the IBRD will require the Borrower to promptly upon notice refund an amount equal to the amount of said payment to the IBRD. Amounts refunded to the Bank upon such request shall be cancelled. The loan proceeds will be administered by the Ministry of Finance.

99. **Although an audit of the use of the funds may not be required, the Bank reserves the right to ask for an audit of the dedicated deposit account where all withdrawals from the Loan Account will be deposited, if the fiduciary risk of the operation, currently rated as moderate, rises as a result of changes in the control environment surrounding this operation.** This audit, if asked for, will cover the accuracy of the debits and credits made under the account, including accuracy of exchange rate conversions; confirming that the account was used only for the purposes of the operation and that no other amounts have been deposited into the account. The timeline for submission of the audit report to the Bank is no later than six months from the date a request for such audit is issued.

## 5.4 MONITORING, EVALUATION AND ACCOUNTABILITY

100. **Implementation and coordination responsibilities.** The responsibility for implementing the program rests with the Ministry of Development and International Cooperation, which coordinates all relevant activities with other ministries. The Government takes the lead in monitoring progress in implementation of this operation. Given the importance and the policy areas of the program, the Prime Minister's office and the Ministry of Finance are also involved in the monitoring of the program design and implementation.

101. **Supervision by the Bank.** Regular supervision allows the Bank to continue providing policy advice and technical assistance to the institutions involved in the implementation of the program of reform, notably through its staff based in the field. The Bank will continue to maintain continuous dialogue with the relevant government ministries and will conduct regular reviews in close collaboration with other partners. This will take the form of supervision missions, at times joint with other donors in the case of specific reforms. The continuous policy dialogue and engagement of the Bank on a medium-term reform agenda will help the supervision process.

[19] Upon request of the GoT, the Central Bank of Tunisia opens a dedicated deposit account in foreign currency to receive funds related to policy-based loans. This dedicated deposit account is opened by donor and by operation in order for the government to keep track of the funds before being transferred to single treasury account in local currency.

102. **Data availability to monitor the progress of reforms is generally good, but with some areas of difficulty**. The Bank and other development partners will continue to provide support to the Government to strengthen monitoring and evaluation, improve data quality and management and enhance capacity for using development outcomes to inform policy making.

103. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org"

## 6. SUMMARY OF RISKS AND MITIGATION

104. **The overall risk rating of this operation is high.** The major risks to the operation's ability to achieve its development objective include: (i) political and governance; (ii) macroeconomic; (iii) institutional capacity for implementation and sustainability; (iv) stakeholder and (v) security. Details for each of these areas are provided below:

105. *Political and governance:* A national unity Government was formed in late August 2016. It was designed to counter the rise of social tensions since the beginning of 2016, and is characterized by greater participation of civil society and accountable decision-making to ensure endorsement of the reforms under preparation. Progress on the economic and job fronts is needed to lower social tensions. Opposition to reforms might also come from some of the entrenched economic and social interest groups, including business groups and worker unions. A better understanding of such interest groups, including through the planned political economy work, can help identify ways to ensure their buy-in.

106. *Macroeconomic*: Uncertainty about the economic outlook related to the health of the global economy and the crisis in Libya, as well as pressure on the fiscal and balance of payments deficits pose significant risk to economic and political developments in Tunisia. Lower economic growth and additional pressure in the labor market could lead to renewed social tensions and reinforce a sense of lack of economic opportunity. The measures supported by this operation aim to facilitate both public and private investments. A strong track record in the implementation of the EFF with the IMF is likely to improve confidence among domestic and international investors on the commitment of the Government to implement a sound reform program.

107. *Institutional capacity for implementation and sustainability:* While the Government has made substantial progress on the reform front, some bottlenecks persist. First, Parliament has a

busy schedule including some important political reforms (related to municipal elections and governance). In addition, some political groups in Parliament could oppose certain reforms. Capacity building provided to parliamentary commissions, and positive political messaging around reforms from a range of international actors, can help mitigate these risks. Second, coordination across agencies and ministries can be challenging for certain actions, as was the case in the previous DPL series. Third, the move from the adoption of reforms to their implementation requires substantial interagency coordination and the buy-in of the bureaucracy. Opposition from part of the administration can lead to incomplete reform implementation. Technical assistance to the Government throughout the adoption and implementation processes, and consistent consultations with civil society and unions, can help mitigate those risks.

108. *Stakeholders:* The Government counts on consensual decision-making in order to maintain the social peace. A tri-partite (Government, unions, employers) meets regularly to discuss reforms. Consensus building means reforms take time and are often gradual. This requires a strengthening of the communication capacity in the Government to lay out to stakeholders and citizens more generally, the costs and benefits of the proposed reforms and the pros and cons of a gradual vs. faster or deeper reform. The Government has taken a pro-active stance on communication for reforms and is integrating public consultation and awareness dimensions its reform programs. Importantly, such communication efforts will need to highlight the costs to the broader community of not engaging into reforms, for instance in terms of foregone growth and financial sustainability. The Bank is also investing considerable effort in awareness raising, building shared diagnostic between the stakeholders and has contributed to strengthening the Government's communication capacity and efforts.

109. *Other (security related):* A significant deterioration of the domestic and regional security situation could not only affect the economic outlook but may also change the Government's reform priorities. To mitigate this risk, the Government has increased security and defense spending and intensified the fight against terrorism.

| **Risk Categories** | **Rating (H, S, M or L)** |
|---|---|
| 1. Political and governance | H |
| 2. Macroeconomic | H |
| 3. Sector strategies and policies | M |
| 4. Technical design of project or program | M |
| 5. Institutional capacity for implementation and sustainability | S |
| 6. Fiduciary | M |
| 7. Environment and social | M |
| 8. Stakeholders | S |
| 9. Other (Security related) | S |
| **Overall** | H |

## ANNEX 1: POLICY AND RESULTS MATRIX

| Prior actions | Results framework | | |
|---|---|---|---|
| | **Indicator** | **Baseline (2016)** | **Target (2018)** |
| **Improving the Business Environment** | | | |
| Prior action #1: The four implementing decrees of the new Competition Law No. 2015-36 dated September 15, 2015-Decree No. 2016-780 dated June 13, 2016, Decree No. 2016-1148 dated August 19, 2016. Decree No. 2016-1204 dated October 18, 2016, and Decree No. 2017-252 dated February 8, 2017- have been published in the Official Gazette No. 51 dated June 24, 2016, the Official Gazette No. 72 dated September 2, 2016, the Official Gazette No. 87 dated October 25, 2016, and the Official Gazette No. 13 dated February 14, 2017, respectively. | Number of anti-competitive practices prevented or eliminated. | 3 | 6 |
| Prior action #2: The new Investment Law No. 2016-71 dated September 30, 2016, reinforcing the rights and guarantees of investors and market access regulation, and its implementing decree, Decree No. 2017-390 dated March 9, 2017, establishing the unit at the Ministry of Development, Investment and International Cooperation responsible for streamlining investment entry authorizations, have been published in the Official Gazette No. 82 dated October 7, 2016 and the Official Gazette No. 25 dated March 28, 2017, respectively. | Publication and availability on the website of the MDICI of the following: (i) the list of activities subject to investment entry authorization, the deadlines, procedures and the terms and conditions for their granting; (ii) the draft report for consultations as well as the final report on the recommendations and concrete proposals for streamlining investment entry authorizations | Not available | All information and documents are readily available on the website of MDICI |

| | | | |
|---|---|---|---|
| Prior action #3: The Decree No. 2017-394 dated March 29, 2017, establishing a unified public investment management framework for public investment projects (PIP) and public private partnership (PPP) projects to cover the appraisal, selection and prioritization, financing modalities and continuous monitoring of all investment projects has been published in the Official Gazette No. 26 dated March 31, 2017. | Share of investment projects for which a feasibility study including a cost-benefit analysis has been completed during the pre-investment phase | 40% | 80% |
| Prior action #4: The Minister of Finance and the Minister of Transport have issued Circular No. 86 dated November 14, 2016, replacing Circular No. 19 dated March 30, 2011, to introduce the digitization of remaining port procedures. Circular No. 86 has been published on the website of the Ministry of Finance. | Container dwell time (in days) | 16.6 | 12 |
| **Supporting Entrepreneurship and Deepening Access to Finance** | | | |
| Prior action #5: The Council of Ministers has approved on April 28, 2017, and the Head of Government has transmitted to Parliament on May 2, 2017, the draft Code for Seed and Equity Capital (Code des Organismes d'Investissment Collectif) enhancing access to finance of young firms and entrepreneurs. | Amount of seed and equity capital raised from investors | 200 million Dinars per year on average in 2012-16 | 300 million Dinars per year on average in 2017-18 |
| Prior action #6: The Council of Ministers has approved on February 24, 2017 and the Head of Government has transmitted to Parliament on February 27, 2017, the draft Law (*loi organique*) on Credit Bureau improving credit information and promoting access to credit for young MSMEs and entrepreneurs. | Number of private credit bureau licensed and operational | 0 | 1 |
| Prior action #7: The new Law of Collective ProceduresNo. 2016-36 dated April 29 2016, simplifying Tunisia's bankruptcy regime has been published in the Official Gazette No. 38 dated May 10 2016. | Number of cases initiated under the new law on collective procedures | 0 | 200 |
| Prior action #8: To improve households' access to housing finance, the Decree No. 2016-1126 dated August 18, 2016, revising the eligibility criteria of the Social Housing Promotion Fund (FOPROLOS *or Fonds de Promotion du Logement pour les Salariés*) has been published in the Official Gazette No. 71 dated August 30, 2016. | Number of FOPROLOS loans | 286 per annum on average in 2013-15 | 600 |

## ANNEX 2: LETTER OF DEVELOPMENT POLICY

**Ministère du Développement, de l'Investissement**
**et de la Coopération Internationale**

2 - MAI 2017

n° 2702

**Monsieur Jim Yong Kim**
**Président du Groupe de la Banque Mondiale**
**The World Bank**
**1818 H Street, NW**
**Washington DC, 20433**
**Etats-Unis d'Amérique**

### Lettre de politique de développement

***Programme d'appui budgétaire 2017***

*Monsieur le Président du Groupe de la Banque mondiale*

### I. Contexte pays

Après avoir réussi sa transition politique et défini les orientations stratégiques pour la période à venir, la Tunisie s'apprête à concrétiser la nouvelle vision de développement à travers l'élaboration du Plan Stratégique 2016-2020 devant remettre le pays sur la voie de la reprise économique et du développement avec l'appui de ses partenaires stratégiques et notamment le Groupe de la Banque Mondiale.

Les priorités de l'action gouvernementale pour la période à venir ont été consolidées par le « Document de Carthage » balisant l'itinéraire du nouveau Gouvernement d'Union Nationale mis en place suite à l'initiative du Président de la République et les concertations avec les partis politiques, les organisations nationales et la société civile

Plus concrètement, les priorités de la prochaine étape s'articulent autour de :

- La lutte contre le terrorisme,
- L'accélération du rythme de croissance,
- La lutte contre la corruption et la consécration des attributs de la bonne gouvernance,
- La préservation des équilibres financiers et la poursuite de la mise en œuvre de politiques sociales efficaces,
- L'élaboration d'une politique dédiée aux villes et aux collectivités locales,

- ✓ Le renforcement de l'action du gouvernement et la mise en place de toutes les institutions de l'Etat.

Le nouveau Gouvernement doit affronter de grands défis d'ordre économique, social et sécuritaire.

Dans ce cadre, l'action gouvernementale s'est focalisée à rétablir la confiance et la sécurité, à améliorer le climat des affaires, à accélérer le rythme des réformes structurelles, ainsi qu'à réduire les pressions sur les grands équilibres et mobiliser les financements appropriés de l'économie.

En effet, le Gouvernement s'est penché sur l'accélération de l'exécution des investissements publics en difficulté. En fait, un projet de loi relative à l'accélération des grands projets publics et privés est adopté par le gouvernement et soumis à l'examen de l'Assemblée des Représentants du Peuple (ARP). Cette action permettra de déroger à certaines dispositions et réglementations pour accélérer l'approbation et la mise œuvre des investissements. Cette initiative prévoit en même temps la mise en place d'un mécanisme qui veillera à la sélection et l'accompagnement des projets en toute transparence.

De même, une attention particulière a été accordée à la gestion du dossier sécuritaire. L'action du Gouvernement en matière de lutte contre le terrorisme et la contrebande est devenue proactive et prompte.

En matière de réformes structurelles, le Gouvernement a retenu un programme de réformes majeures qui vise principalement l'approfondissement et l'accélération du processus de réformes et l'introduction de changements au niveau des politiques économiques et sociales se traduisant par de nouvelles règles et de nouvelles pratiques améliorant le fonctionnement de l'économie et générant une croissance inclusive et un développement durable. Ce programme retient cinq piliers essentiels : l'amélioration du financement de l'économie, le renforcement des équilibres budgétaires, le développement des ressources humaines, la refonte des filets de protection sociale et le renforcement du cadre institutionnel et réglementaire.

Une série de réformes ont été d'ores et déjà adoptées, en l'occurrence, la loi sur le partenariat public-privé, la loi sur la concurrence et les prix, le statut de la Banque Centrale de Tunisie et la loi bancaire.

Dans le même contexte, la loi de l'investissement est promulguée ; l'objectif de cette réforme consiste à améliorer davantage l'environnement des affaires, à réduire les obstacles liés à l'accès au marché et à instaurer une bonne gouvernance institutionnelle. En plus, des avancées notables ont été enregistrées au niveau de l'élaboration de la réforme fiscale et douanière. La loi sur les incitations fiscales a été également adoptée ;

Les principaux axes de cette réforme couvrent l'amélioration de l'accès aux marchés, de la protection des investisseurs et du renforcement de la gouvernance ainsi que de la consécration de l'équité fiscale, de la simplification des procédures fiscales et de la modernisation de l'administration fiscale.

L'organisation de la Conférence internationale sur l'investissement « Tunisia 2020 » a réussi à remettre la Tunisie sur la carte internationale de l'investissement et faire preuve de l'élan de sympathie et du soutien manifeste de la communauté internationale à la transition économique du pays. Avec un bilan assez important de déclarations d'appuis technique et financier de la part des partenaires de la Tunisie, des intentions d'investissement et des témoignages de « success stories » dans des secteurs à fort potentiel d'investissement et de création de valeur, les perspectives d'une nouvelle dynamique d'investissement et de croissance en Tunisie ne pourront être que prometteuses.

D'autre part, la Loi de Finances 2017, approuvée par l'ARP, a eu pour objectif la correction des déséquilibres des finances publiques et la relance de l'économie du pays. Elle vise également davantage de justice sociale et la répartition de la charge fiscale tout en veillant au soutien des catégories vulnérables et à faible revenu.

En termes de perspectives macroéconomiques, les prévisions pour l'année 2017 tablent sur une croissance économique de 2.3% contre 1% en 2016 caractérisée particulièrement par une croissance des secteurs hors agriculture et pêche de 2%. Le rythme de croissance attendu pour 2017 est essentiellement imputable à la reprise attendue au niveau du phosphate ainsi qu'au regain de l'activité touristique.

Du côté de la demande, les prévisions pour l'année 2017 se basent sur des sources de croissance plus équilibrées avec une contribution positive de l'investissement, notamment privé, et du commerce extérieur.

Compte tenu de ces considérations, les besoins de financement du pays restent ainsi élevés et sont estimés à 12 740 MD pour l'année 2017.

C'est dans ce cadre que s'inscrit le nouveau Programme d'Appui aux politiques de développement qui vient s'inscrire dans l'appui technique et financier apporté par la Banque Mondiale à l'effort de développement national.

Ce programme de réformes s'inscrit dans le cadre des politiques du nouveau Plan Stratégique 2016-2020 visant à promouvoir davantage la bonne gouvernance et la lutte contre la corruption, la restructuration de l'économie tunisienne, le développement humain et l'inclusion sociale, le développement régional, ainsi que l'orientation vers l'économie verte.

## II. Politiques et réformes inscrites dans le Plan Stratégique 2016-2020

Le Plan Stratégique 2016-2020 est le premier plan de développement de la deuxième république. Il consacre la vision de la Tunisie nouvelle et vise à assurer une visibilité pour les opérateurs économiques ainsi que pour tous les partenaires techniques et financiers de la Tunisie. Il importe de noter que le Plan, comme la Note d'orientation stratégique, ont été élaborés selon une approche participative.

Le pays œuvrera durant ce Plan à renforcer et consacrer la bonne gouvernance, réformer l'administration et lutter contre la corruption. Pour ce faire, un système national d'intégrité sera mis en place et les principes de bonne gouvernance à l'échelle sectorielle et locale seront renforcés. Le Gouvernement veillera à promouvoir la production et la diffusion de l'information statistique conformément aux normes internationales et garantir l'accès à l'information. De plus, les règles de la bonne gouvernance seront appliquées au niveau des établissements et entreprises publiques. Ainsi, les fonctions de président du conseil d'administration et celle de directeur général de l'entreprise seront dissociées.

Pour que l'administration soit plus efficace et au service du citoyen et du développement, la réforme de l'administration visera la mise en place d'un statut particulier de la haute fonction publique, le renforcement des compétences administratives et la digitalisation de l'administration.

Le plan repose aussi sur la transformation de l'économie en un hub économique. L'objectif est de diversifier le tissu économique, pour assurer un fort potentiel d'exportation et de création d'emplois et ce, à travers la conception de politiques et de stratégies sectorielles appropriées, l'amélioration de l'infrastructure et de la logistique et le renforcement des capacités et des ressources allouées au système national de la recherche et de l'innovation. Ceci permet aussi l'amélioration la productivité et la montée dans les chaines de valeur à l'échelle mondiale et la création d'un cadre propice à l'innovation et à la créativité.

Par ailleurs, l'économie numérique sera d'un intérêt important. Les efforts seront intensifiés en vue de la diffusion de la culture numérique et la numérisation des supports pédagogiques, la migration vers une administration électronique au service du citoyen et de l'entreprise, la mise en place de la stratégie Digital Tunisia et le développement de l'infrastructure numérique.

Toutefois, la transformation de l'économie est aussi tributaire de l'amélioration du climat des affaires et des réformes de la fiscalité, des douanes, du système bancaire, du code de change, du marché financier et des assurances ainsi que des réformes foncières.

Le développement humain et l'inclusion sociale occupent une place de choix dans les priorités du prochain quinquennat. Le Gouvernement veillera, d'une part, à rehausser la performance du système éducatif et à améliorer l'employabilité. D'autre part, une attention particulière sera portée à la politique de promotion de la femme, de la famille et de l'enfance ainsi qu'au soutien des catégories sociales vulnérables. Une réforme du système des transferts sociaux sera axée sur le ciblage des bénéficiaires.

De plus, la promotion de la culture et le renforcement de la couverture sanitaire seront également parmi les axes retenus dans les priorités de la promotion sociale du prochain Plan.

Le prochain Plan veillera également à la concrétisation des ambitions des régions à travers le développement de la décentralisation et la mise en place des fondements de la démocratie locale, la connectivité des régions et l'amélioration de leur attractivité. Le Gouvernement est déterminé à mettre en œuvre un processus de développement basé sur une discrimination positive au profit des régions défavorisées à travers l'affectation d'environ 70% du volume des investissements publics pour ces régions.

Enfin, le Plan Stratégique repose sur la promotion de l'économie verte comme pilier du développement durable, le renforcement de l'aménagement du territoire équilibré et équitable et la rationalisation de l'utilisation des ressources naturelles.

### III- Mesures du programme d'appui aux politiques de développement

Le nouveau programme d'appui aux politiques de développement couvre deux piliers principaux de politique économique qui visent l'amélioration de l'environnement des affaires et l'appui et le renforcement de l'entreprenariat et de l'accès au financement.

#### Pilier 1. Amélioration de l'environnement des affaires et du cadre de la concurrence

*(i) Renforcement de l'accès au marché, la concurrence et la transparence*

Dans le but de promouvoir une plus grande ouverture des marchés aux investisseurs, de stimuler l'investissement domestique et d'attirer les investissements étrangers dans un bon cadre juridique de la concurrence, le Gouvernement a approuvé et publié :

- les quatre décrets d'application de la nouvelle loi sur la concurrence et les prix instituant et renforçant notamment le Conseil de la concurrence pour veiller à toutes les exigences de la concurrence loyale et à la transparence des prix.
- afin de promouvoir une plus grande ouverture des marchés aux investisseurs, de stimuler l'investissement domestique et d'attirer les investissements étrangers : (i) la loi sur l'investissement a été publié au JORT ; (iii) le décret créant l'unité de

gestion par objectif en charge d'identifier et de proposer les autorisations à supprimer ou remplacer par des cahiers de charge a été publié au JORT.

*(ii) La Gestion des investissements publics*

En vue d'améliorer la qualité des investissements publics, le Conseil des Ministres a adopté un décret instituant un cadre unifié de gestion des investissements publics qui établit un processus coordonné de choix et de décision d'investissement public et d'investissement public- privé dans le cadre des Partenariats public- privé couvrant notamment la sélection et la priorisation des projets basée sur l'analyse coûts-bénéfices et l'efficacité des dépenses, les modalités de financement et de suivi continu de l'exécution et le coût financier de tous les projets d'investissement. Ce décret instaure un Comité National d'approbation des Projets et présidé par le Ministère du développement, de l'investissement et de la coopération internationale qui veillera à l'amélioration de la préparation, de la mise en œuvre et du suivi des projets d'investissements publics.

*(iii) Facilitation du commerce, du transport et de la logistique*

En matière de facilitation du commerce, les Ministères des Finances et du Transport ont adopté et publié une nouvelle circulaire modifiant la circulaire 19 pour introduire la numérisation progressive des procédures portuaires ce qui devrait améliorer le suivi et l'efficacité de la logistique portuaire.

Dans ce cadre, et dans le but d'améliorer l'efficacité des ports et de réduire le temps de séjour des conteneurs et marchandises dans les ports, les ministères du Transport et des Finances veilleront à une évaluation du temps mis pour exécuter toutes les procédures portuaires pour dédouaner les marchandises.

**Pilier 2 : Appui à l'entreprenariat et à l'accès au financement**

*(i) Amélioration de l'écosystème du financement de l'entreprenariat : organismes de placement en capital investissement*

Face à des besoins de consolidation des apports financiers aux entreprises et d'améliorer leur accès au financement, le Gouvernement a adopté un projet de loi régissant les organismes de placement en capital investissement, en les classant en deux catégories à savoir les Sociétés d'investissement à capital risque et les Fonds en capital investissement. Ce code vient, d'une part, harmoniser une série de textes réglementaires régissant cette activité d'investissement de manière à être plus efficace et transparent à appliquer, et d'autre part, l'accès des investisseurs à ce texte est rendu plus simple de par son unité.

*(ii) Crédit bureau*

Afin d'améliorer les mécanismes de soutien financier et d'accompagnement aux MPME et à l'entreprenariat, le Gouvernement a adopté et transmis au Parlement une loi sur le crédit bureau pour permettre aux établissements de crédit de mieux évaluer et optimiser le risque dans leurs activités d'octroi de crédit et ce à travers la disponibilité d'informations adéquates, fiables et accessibles.

A cet effet, la Banque Centrale de Tunisie aurait une base légale pour octroyer une licence à un premier crédit bureau suite à l'adoption de la loi par le parlement en 2017.

**(iii)** ***Renforcement de l'environnement des affaires et du financement***

Dans le souci d'améliorer l'environnement des affaires et d'améliorer l'accès au financement, la loi sur les procédures collectives a été publiée dans le but de renforcer les procédures de faillite et de recouvrements des créances notamment celles des PME en difficulté.

***(iv) Accès des ménages moyens au crédit logement***

Dans un souci de mieux répondre aux besoins des ménages en matière d'acquisition et d'amélioration du logement, le Gouvernement a adopté et publié le décret révisant les critères d'éligibilité au Fonds de Promotion du Logement pour les Salariés FOPROLOS et ce en tenant compte de l'évolution du secteur de l'immobilier et de la capacité financière des salariés moyens.

*La consistance des actions de réforme prévues dans le présent programme atteste de la ferme volonté de la Tunisie à s'engager dans un nouveau processus de développement et de construction susceptible d'ancrer l'esprit de la démocratie et d'assurer la prospérité économique et le progrès social conformément aux aspirations de la révolution.*

*L'assistance technique et financière à cet effort de réforme s'avère nécessaire pour faire face aux défis présents et futurs. L'Etat tunisien est ainsi résolu à mettre en œuvre avec l'appui de ses partenaires, toutes les réformes prévues dans le cadre de ce programme afin d'assurer la réussite de la phase transitoire et sollicite la Banque Mondiale pour un appui financier approprié.*

**Mohamed Fadhel ABDELKEFI**

**Ministre du Développement, de l'Investissement et de la Coopération Internationale**

7

**Ministry of Development, Investment**

**And International Cooperation**

**Mr Jim Yong Kim**
**President of the World Bank Group**
**The World Bank**
**1818 H Street, NW**
**Washington DC, 20433**
**United States of America**

**Letter of Development Policy**

***Development Policy Loan 2017***

*To the President of the World Bank Group*

*Dear Sir,*

## I. Country context

Having successfully undergone its political transition and defined the strategic orientations for the future period, Tunisia is getting ready to crystallize its new development vision through the elaboration of the Five Year Development Plan 2016-2020 so that the country can move ahead with its economic recovery and development with the support of its strategic partners and namely the World Bank Group.

Governmental action priorities for the future period have been consolidated by the « Carthage Document » thus tracing out the itinerary of the new National Unity Government which has been set up at the initiative of the President of the Republic and after concertations with the political parties, national organisations and civil society.

In concrete terms, the priorities of the next stage focus on the following:

- ✓ Combatting terrorism,
- ✓ Accelerating the pace of growth,
- ✓ Combatting corruption and promoting good governance,
- ✓ Preserving financial equilibrium and continuing with the implemention of effective social policies,
- ✓ Elaboration of a dedicated policy for the towns and local authorities,

- ✓ Enhancing the government's action and setting up all the institutions of the State.

The new government is facing great economic, social and security challenges.

Governmental action thus concentrated on re-establishing confidence and security, on improving the business climate, accelerating the pace of structural reforms and also on reducing the pressure on the key factors to be brought back into balance and mobilizing appropriate funding for the economy.

The Government in fact has focussed on speeding up those public investments which are in difficulty. A draft law on accelerating great public and private projects has been adopted by the government and submitted for review by the Assembly of the People's Representatives. (APR). This will make it possible to waive some of the provisions and regulations to speed up the approval and the implementation of investments. This initiative has also provided for a mechanism to monitor the selection and implementation of the projects in complete transparency.

Particular attention, furthermore, has been given to the management of security and the Government's action in combatting terrorism and contraband has become proactive and prompt.

As for structural reforms, the Government has chosen a Major Reforms Programme (MRP) which mainly aims at the enhancement and acceleration of the reforms process and the introduction of changes in economic and social policies which will then reflect new rules and practices to improve the functioning of the economy and ensure inclusive growth and sustainable development. This programme is based on five main pillars: improving the funding of the economy, strengthening budgetary balance, capacity building of human resources, reshaping the social safety nets and strengthening the institutional and regulatory framework.

A series of reforms have already been adopted such as the law on public-private partnership, the law on competition and prices, the status of the Central Bank of Tunisia and the Banking Law.

Within the same context, the investment law has been promulgated; the aim of this reform is to further enhance the business environment, reduce the impediments in accessing the market and establishing good institutional governance. Good progress has been made in the elaboration of the fiscal and customs reform. The law on fiscal incentives has also been adopted. The main axes of this reform pertain to improving access to markets, the protection of the investors, strengthening of governance, ensuring fiscal fairness, simplification of fiscal procedures and the modernisation of the fiscal administration.

The organisation of the International Conference on Investment « Tunisia 2020 » has managed to put Tunisia back on the international investment map and generated a

momentum of sympathy and clear support of the international community for the country's economic transition. With quite an impressive number of declarations of technical and financial support from Tunisia's partners, investment intentions and testimonies of « success stories » in those sectors with a strong investment potential and value creation, so that the perspectives of new investment dynamics and growth in Tunisia are most promising.

Furthermore, the 2017 Finance Law which was approved by the Assembly of the People's Representatives aims to rectify the imbalances in public finances and to boost the country's economy. It also aims at social justice and the distribution of the tax burden whilst at the same time ensuring support for vulnerable categories and those on low incomes.

As for macro-economic perspectives, the 2017 forecasts indicate a 2.3% economic growth against 1% in 2016 characterized in particular by a 2% growth other sectors excluding agriculture and fishing. The rate of growth expected for 2017 is basically attributable to an upswing in the phosphates sector and upturn in touristic activity.

As for demand, the 2017 forecasts are based on more balanced sources of growth with a positive contribution of investments, especially private ones and on foreign trade.

In view of all these considerations, the country's funding needs are high and are estimated at 12 740 million Tunisian Dinar for 2017.

The new Support Programme for development policies is within this framework alongside the technical and financial support of the World Bank for national development efforts.

This reform programme is part of the policies of the new 2016-2020 strategic plan for the promotion of good governance and combatting corruption, restructuring the Tunisian economy, human development and social inclusion, regional development and moving towards a green economy.

## II. Policies and reforms in the Five Year Development Plan 2016-2020

The Five Year Development Plan 2016-2020 is the first development plan of the second republic. It outlines the vision of the new Tunisia and aims to ensure visibility for economic operators and for all the technical and financial partners of Tunisia. This Plan, like the Strategic Guidelines Note, was elaborated on the basis of a participative approach.

During this plan, the country will strive to strengthen and enhance good governance, reform the administration and combat corruption. To achieve this goal, a national integrity system will be set up and the principles of good governance on a sectorial and local level will be reinforced. The Government will promote the production and dissemination of statistical information in conformity with international standards and

also guarantee access to information. Furthermore, the rules of good governance will be applied to the establishments and public enterprises. Thus the functions of the president of the board of directors and those of the director general will be dissociated.

To ensure that the administration becomes more efficient and at the service of the citizen and of development, the reform of the administration will aim at setting up a particular status for the senior public service positions, administrative capacity building and the digitalisation of the administration.

The plan is also based on transforming the economy into an economic hub. The objective is to diversify the economic fabric in order to ensure a strong export potential and job creation through an appropriate design of sectorial policies and strategies, improving the infrastructure and logistics, capacity building and resources allocated to the national research and innovation system so as to improve productivity and move up the value chain on an international scale and create an enabling environment for innovation and creativity.

The digital economy will furthermore be of great interest. Efforts will be intensified to spread digital culture and the digitalisatioon of pedagogical supports, migration towards an electronic administration at the service of the citizen and the enterprise, setting up the Digital Tunisia strategy and the development of the digital infrastructure.

However, transforming the economy depends on improving the business climate, reforming the tax system, the customs, banking system, code change, financial and insurance market as well as land reforms.

Human development and social inclusion have top priority in the next five-year period. The government will also strive to enhance the performance of the educational system and improve employability. Particular attention will be paid to the promotion of women, the family and children and supporting vulnerable social categories. A reform of the social transfers system will focus on targeting the beneficiaries.

Furthermore, the promotion of culture and strengthening the health coverage will also be amongst the priorities of social promotion in the next plan.

The next plan will also monitor the crystallisation of the regions' ambitions through the decentralisation process and establishing the foundations of local democracy, connectivity of the regions and improving their attractiveness.

Finally the strategic plan is based on promoting the green economy as a pillar of sustainable development, enhancing a well-balanced and equitable land development and rationalisation in the utilisation of natural resources.

## III- Measures of the support programmes for development policies

The new support programme for the development policies covers two main economic policy pillars to improve the business environment and to support and strengthen entrepreneurship and access to funding.

### Pillar 1. Improving the business environment and the competition framework

#### *(i) Enhancing access to the market, competition and transparency*

In order to promote a greater opening up of the markets to investors, to stimulate domestic investments and attract foreign investments within a good legal competitive context, the Government has approved and published:

- Four implementing decrees of the new law on competition and prices thus instituting and strengthening the Competition Council to watch over all the requirements of fair competition and transparency of prices.
- To promote a greater opening up of the markets to investors, to stimulate domestic investments and to attract foreign investments: (i) the Investment Law was published in the Official Journal of the Tunisian Republic (JORT); (iii) the decree creating the management unit per objective so as to identify and propose those authorisations to be phased out or replaced by specifications and this too was published in the JORT.

#### *(ii) Management of public investments*

To improve the quality of public investments, the Council of Ministers adopted a decree instituting a unified public investments management framework which establishes a coordinated process for public investment selection and decision and for public-private investment within the framework of public-private Partnerships covering the selection and prioritisation of projects based on the cost-benefit analysis and cost effectiveness, financing modalities and continuous monitoring of implementation and the financial cost of all the investment projects. This decree is setting up a National Projects Approval Committee presided by the Ministry of Investment Development and International Cooperation which will monitor improved preparation, implementation and follow-up of public investments projects.

#### *(iii) Facilitation of trade, transport and logistics*

As for the facilitation of trade, the Ministries of Finance and of Transport have adopted and published a new circular modifying circular 19 in order to introduce the progressive digitalisation of port procedures to improve the monitoring and efficacy of port logistics.

In order to improve the efficacy of the ports and to reduce the time the containers and goods spent waiting in the ports, the Ministries of Transport and of Finance will ensure

an evaluation of the time spent in implementing all the port procedures for customs clearance of the goods.

**Pillar 2: Support for entrepreneurship and access to financing**

***(i) Improving the entrepreneurship funding ecosystem: investment organisms for investment capital.***

In view of the need to consolidate the financial supports for the enterprises and improve their access to financing, the Government has adopted a draft law regulating the investment organisms dealing with capital investment, by classifying them into two categories, venture capital investment companies and Equity Funds. This Code thus harmonizes a series of regulatory texts overseeing this investment activity so as to ensure greater efficacy and transparency in the application and access for investors to this text which has been greatly unified and simplified.

***(ii) Credit Bureau***

To improve the financial support and coaching mechanisms for the SMEs and entrepreneurship, the Government has adopted and submitted to the Parliament the law on the credit bureau to enable the credit agencies to better evaluate and optimize risks when granting credits through the availability of adequate, reliable and accessible information.

The Central Bank of Tunisia would thus have a legal basis for granting a licence to a first credit bureau after the adoption of the law by parliament in 2017.

**(iii)** ***Strengthening the business and financing environment***

To strengthen the business environment and improve access to financing, the law on collective procedures has been published so as to further strengthen the bankruptcy and credit recovery proceedings, especially for SMEs which are in difficulty.

***(iv) Access of average households to mortgages***

To better cater for the needs of the households to acquire and improve their housing, the Government revised, through a decree, the eligibility criteria for the Social Housing Promotion Fund FOPROLOS (bearing in mind the changes in the real estate sector and the financial capacity of the average wages).

The robustness of the reforms scheduled in the present programme bear witness to Tunisia's firm will to move along with the new development and construction process in order to root the spirit of democracy, ensure economic prosperity and social progress in conformity with the aspirations of the revolution.

Technical and financial assistance is necessary to support the reform efforts and to take up the present and future challenges. The Tunisian State is firmly committed to implement, with the support of its partners, all the reforms scheduled in this programme so as to ensure a successful transitional phase and is thus requesting appropriate financial support from the World Bank.

**Mohamed Fadhel ABDELKAFI**
**Minister of Development, Investment and International Cooperation**

## ANNEX 3: FUND RELATIONS ANNEX

## TUNISIA—ASSESSMENT LETTER FOR THE WORLD BANK [20]

May 4, 2017

*This letter provides an assessment of economic conditions and policies based on the staff level agreement recently reached for Tunisia's first review under the Extended Fund Facility (EFF).[21] Program performance since May 2016 was weak due to the political transition and the collapse of confidence in the aftermath of violent attacks. Growth remained at 1 percent over 2015–16, too low to reduce high unemployment, while external and fiscal deficits further widened. The reform momentum picked up over recent months after the new unity government took office, with progress on implementation of delayed structural reforms and preparation of critical new ones, and agreement on strong and equitable fiscal adjustment in 2018. The IMF Executive Board is scheduled to consider the first EFF review on June 9, 2017.*

**IMF staff and the Tunisian authorities reached a staff-level agreement on April 17, 2017 on the policies needed to complete the first EFF review.** Recent progress in advancing delayed reforms, guided by the priorities of the "Accord de Carthage" and the government's Five-year Development Plan, resulted in agreement on a policy agenda that can be supported under the EFF. Conditional on meeting prior actions on the 2018 tax package, the establishment of a large taxpayers' unit, and the application of the fuel price adjustment mechanism, the Board will consider the review in early June. Successful completion would make available SDR 227 million (about US$308 million) to the Tunisian government, bringing total disbursements under the EFF to US$628 million. Intensive discussions with the authorities will continue over the next months. The Second Review under the EFF arrangement is scheduled for the fall of 2017.

[20] This assessment reflects the conclusions of the IMF mission for the First Review under the EFF, which visited Tunis during April 3–18, 2017. The last Article IV consultation was concluded in September 2015.

[21] See Press Release No. 17/135.

**Tunisia faces high external and fiscal deficits, increasing debt, and growth that is too low to reduce unemployment.** The economy grew by only 1 percent in 2015 and 2016, reflecting persistent weaknesses in tourism, mining, and manufacturing. Unemployment remains elevated (15.5 percent at end-2016). In 2017, real GDP growth is expected to double to 2.3 percent on the back of agriculture, phosphates, and tourism, but high uncertainty will continue to affect investment. Inflation has been contained in the low single digits but has started to increase in March 2017, fueled by wage increases, customs tariffs increase, and the dinar's depreciation. The combination of weak growth, fiscal policy slippages, and delays with critical structural reforms have translated into a rapidly increasing fiscal deficit and growing public debt in 2016, which reached 6 percent of GDP and 63 percent of GDP, respectively. On the external front, the current account deficit widened to an annualized 10 percent of GDP in the first quarter of 2017, with robust import demand, including for consumption, far exceeding export revenue. These developments contributed to a worsening of financing conditions and recent downgrades by major rating agencies.

**Against this backdrop, deficit reduction and an improvement in budget structure become paramount to ensure fiscal sustainability and adequate service delivery.** The strategy agreed with the authorities aims at stabilizing the fiscal deficit in 2017 at 6 percent of GDP and starting with deficit reduction in 2018 to bring public debt on a downward path after peaking at 72 percent in 2018. The underlying structural deficit (net of one-off items) is projected to improve by 2 percent of GDP in 2018 through increasing tax revenue in an equitable way, implementing the civil service reform strategy that puts the wage bill on a sustainable trajectory, reducing energy subsidies, and containing budget transfers to the social security system. This should create space for higher social spending and public investment in support of job creation and improved living standards. Other priorities on the fiscal front include the adoption of a pension reform strategy by fall 2017, making operational a large taxpayers' unit by January 2018, improving the management of fiscal risks from SOEs, and strengthening budget transparency by strengthened cash management and treasury functions.

**External financing will largely cover budgetary financing needs.** The authorities placed a EUR 850 million Eurobond in February, and received a US$1 billion budget loan from Qatar in April on favorable financing terms. Together with the projected inflows from IFIs and other external partners over 2017, these resources have eased financing pressures in the near term. Efforts to follow-up on the pledges received in the context of the Tunisia 2020 Investor Conference and on opportunities created by the Compact with Africa will positively affect the financing outlook in the medium term.

**More exchange rate flexibility and a tightening of monetary policy will help correct the current account deficit, protect reserves, and counteract inflationary pressures.** The authorities and staff have a common view on the need for greater exchange rate flexibility and maintaining an adequate level of international reserves. Greater flexibility will help adjust the current account deficit by discouraging imports

and stimulating exports. This could be achieved without abrupt changes in the value of the dinar. Moreover, recent monetary policy tightening will counteract increasing inflationary pressures, which are bound to further strengthen through exchange rate pass-through (since 2016, the dinar depreciated 18 percent in nominal terms against the euro) and wage increases. On April 25, the Central Bank raised the policy interest rate by 50 basis points to 4.75 percent; additional tightening should be considered over the next months. The policies supported by the EFF are consistent with gradually increasing reserve cover to reach 100 percent of the Fund's ARA metric.

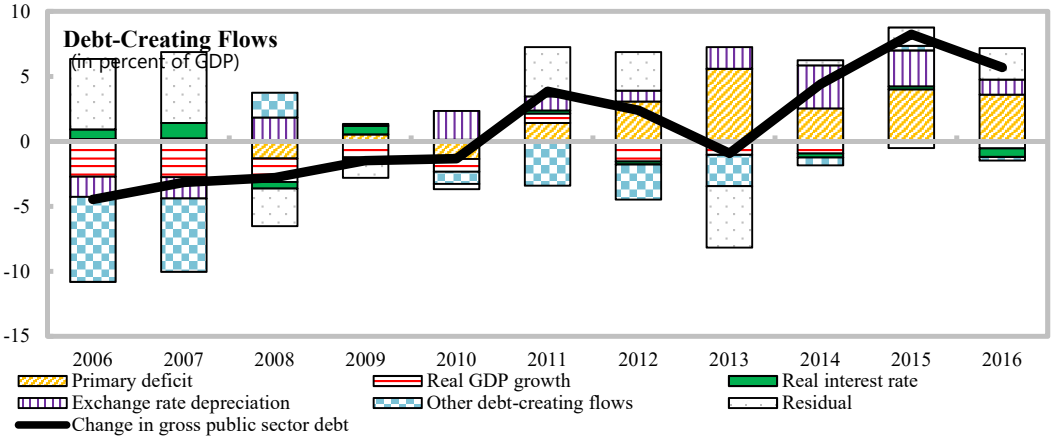
**The authorities have accelerated structural reforms in recent months and are committed to maintain an ambitious pace going forward.** Tunisia's traditional economic model has been based on a large role of the public sector in the economy, which has left limited room for private sector development and has failed to address high unemployment. The authorities are committed to progress towards an economy relying on the private sector as main engine of growth and that creates enough high-quality jobs to absorb the unemployed. The recent acceleration of the structural reform agenda is critical to achieve this objective: in April, the authorities adopted a revised civil service strategy and fundamental legislation for private sector development (implementation decrees for the PPP law, the competition law, and the investment code). Moreover, the three public banks adopted performance contracts for better management, the Ministry of Finance adopted a debt management strategy, and the Central Bank will implement a new manual for risk-based inspections. Next steps on structural reforms include measures to progress with NPL resolution, especially for public banks, to increase access to financing; strengthening the Ministry of Finance's capacity to monitor the performance of public banks and public enterprises; adoption by Parliament of the organic budget law and the law establishing the high anti-corruption authority in Parliament; and progress with a database to underpin the development of a better targeted social safety net.

**Implementation risks remain elevated in 2017 and 2018.** In particular, political tensions in the run-up to the municipal elections in December 2017 may impact the adoption of the 2018 tax package in Parliament; and the reduction in the public wage bill-to-GDP ratio depends on the authorities not granting any new salary increases until 2020 except if growth exceeds the baseline assumption. The authorities seek to manage these risks by communicating their intentions on the tax measures and the public wage bill to main stakeholders early on.

## ANNEX 4: PUBLIC DEBT SUSTAINABILITY ANALYSIS

1. **Debt consolidation in Tunisia has been challenged by low growth and slow fiscal adjustment in the transition period also marked by multiple macroeconomic shocks.** Central Government debt-to-GDP ratio declined from 54.1 percent in 2004 to 49 percent in 2014 – with all of the consolidation occurring in the second half of the 2000's, followed by a period of fiscal expansion and rising debt trajectory. High and consistently positive GDP growth, at an average of 4.3 percent during 2005-2010, accounted for the largest contribution in the decline of debt-to-GDP ratio (Figure 4.1). The primary balance, while small during the 2000s, continued to remain in deficit throughout and contributed positively to the debt-to-GDP trajectory. However, with the onset of political turmoil and uncertainty in Tunisia in 2010, GDP growth turned volatile and averaged a tepid 1.5 percent during 2011-2015, including a year of negative growth in 2011 and growth at only 0.8 percent in 2015 due to a sharp contraction in the tourism sector following two terrorist attacks in the country. Simultaneously, an expansionary fiscal policy was adopted in 2012 to deal with the aftermath of revolution and the primary deficit rose to an average of 4.3 percent of GDP during 2012-2013, compared to an average of zero percent in the previous two years. Despite some consolidation in the subsequent two years, the deficit remained higher than its level in the 2000s and accounted for the largest contribution (in combination with exchange rate depreciation) in the rise in Tunisia's debt trajectory. Debt-to-GDP ratio rose from 39.2 percent in 2010 to 53.2 in 2015, and further to 62.9 percent in 2016.[22]

**Figure 4.1**. Decomposition of Debt-Creating Flows, 2006-2016




Source: Government of Tunisia, IMF for debt, IMF and World Bank staff calculations

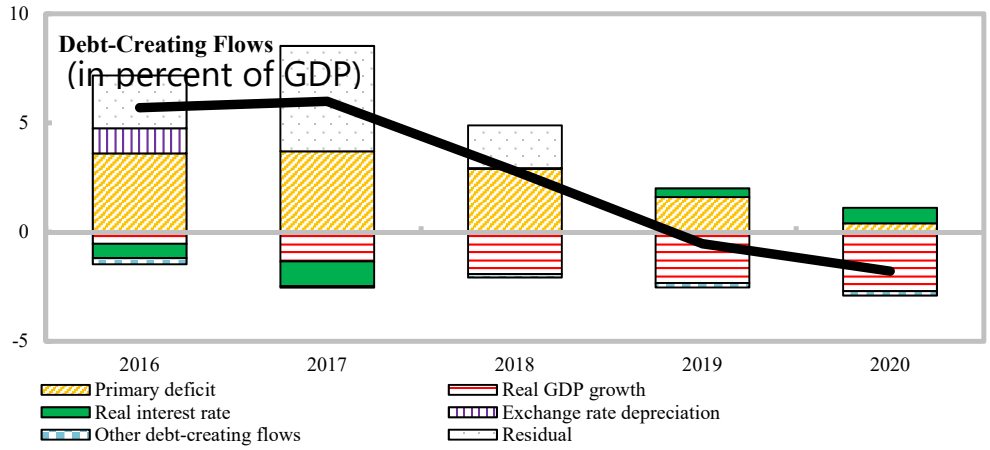
2. **In the medium term, Tunisia's debt trajectory is likely to remain sustainable and under baseline assumptions, and consolidation is expected to resume after 2018.** Central government debt is expected to peak at 71.6 percent of GDP in 2017 before gradually declining to 69.4 percent by 2020, under baseline assumptions of a moderate economic growth, gradual fiscal consolidation and depreciation of the exchange rate. Gross financing needs are simultaneously expected to gradually decline from a high of 10.7 percent of GDP in 2018 to 8.2 percent of GDP

[22] The increase in 2016 was due to the inclusion of postal bank deposits in short-term debt, which are used by the Government for deficit financing.

by 2020, supported by a long maturity profile of Tunisia's debt portfolio which helps maintain amortization obligations below 6 percent of GDP in all years of the forecasting period.

3. **Faster economic growth and fiscal consolidation are critical for debt sustainability.** Economic growth is expected to improve in 2017 at 2.3 percent and accelerate further to 4.1 percent by 2020, supported by a pick-up in mining activities and revival of non-manufacturing industries. Acceleration in real GDP growth is expected to play the largest role in stabilizing the country's debt trajectory (Figure 4.2). In addition, if the proposed fiscal consolidation materializes and growth in wage bill and transfers to SOEs and parastatals are controlled, the primary balance, while remaining in deficit, is expected to decline to an average of 1.6 percent during 2018-2020, but still above its level in the 2000s. The magnitude of debt accumulation in Tunisia, despite consistent primary deficits is also controlled due to the use of below-the-line deficit financing instruments including privatization receipts and drawdown of deposits (average of 0.2 percent of GDP during the forecast years).

**Figure 4.2**. Decomposition of Debt-Creating Flows, 2016-2020




Source: Government of Tunisia, IMF for debt, IMF and World Bank Staff projections

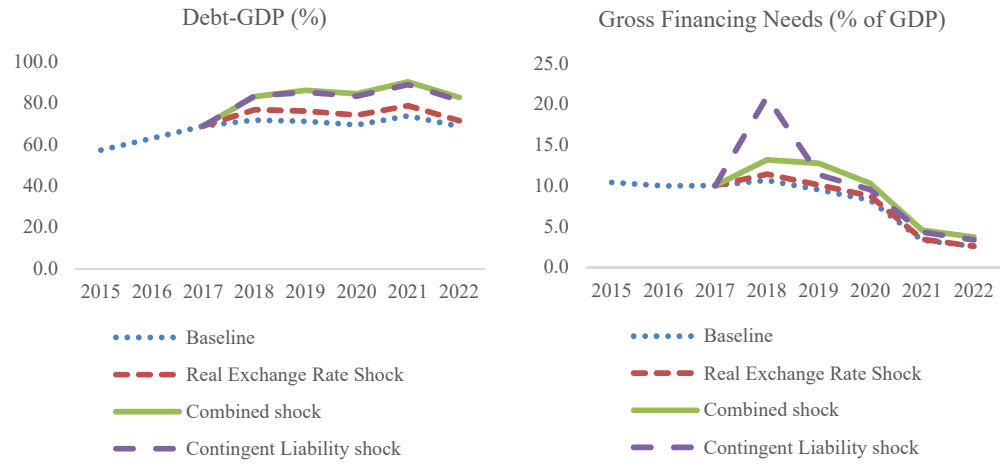
4. **Tunisia's public debt trajectory remains vulnerable to exogenous shocks,** the most prominent of which arise from high exposure to foreign debt and exchange rate fluctuations, subdued growth, and liabilities of SOEs. While public debt remains sustainable under adverse shocks and debt-to-GDP ratio resumes its decline towards the end of medium-term, it could deteriorate significantly compared to the baseline in the short-term (Figure 4.3).

- Realization of contingent liabilities (equivalent to approximately 12 percent of GDP) from ailing SOEs and rising pension fund liabilities could push up the debt-to-GDP ratio to 85 percent in the year of the shock and moderate only slightly the next year due to persistent slower growth, before declining to 83.3 percent by the end of 2020. Realization of contingent liabilities is reflected as a one-time increase in non-interest expenditures equivalent to 10 percent of banking sector assets, which leads to a real GDP growth shock: growth is reduced by one standard deviation for two consecutive years; deterioration in

primary balance lead to higher interest rate; and decline in growth leads to lower inflation (detailed parameters on the shock scenarios are described in table 4.3);

- Nearly two-third of Tunisia's public debt is foreign currency, and an exchange rate shock could push up the debt-to-GDP ratio to almost 77 percent in the near term before declining to 74.1 percent in 2020. The shock assumes a 13 percent real deprecation (equivalent to maximum historical movement), inflation pass-through is estimated at 25 percent, and 17 percent nominal depreciation, which results in a rise in the value of outstanding debt;
- A temporary combined macro-fiscal shock could push up the debt-to-GDP ratio to 86.1 percent before it declines very gradually to approximately 84.4 percent by 2020. This shock assumes, real GDP growth is reduced by one standard deviation for two consecutive years; decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth), simultaneously, fiscal adjustment is reduced to 50 percent of planned adjustment; deterioration in the primary balance results in an increase in interest rates of 25bp for every 1 percent of GDP worsening in the primary balance.

**Figure 4.3**. Debt and Gross Financing Needs under Baseline and Alternative Scenario




Source: Government of Tunisia, IMF for debt, IMF and World Bank staff projections

**Table 4.1: Debt Burden Ratios (Baseline Scenario)**

| (%) | 2005-10 (avg) | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total public debt-to-GDP | 44.5 | 45.5 | 44.5 | 49.0 | 54.9 | 62.9 | 68.9 | 71.7 | 71.2 | 69.4 |
| Total public debt-to-Revenue | 197.2 | 182.6 | 178.4 | 189.7 | 235.4 | 275.9 | 283.5 | 290.2 | 290.4 | 281.9 |
| Debt service-to-GDP | 5.8 | 5.9 | 5.9 | 6.0 | 5.4 | 6.4 | 6.2 | 7.7 | 7.9 | 7.8 |
| Debt service-to-Revenue | 25.6 | 23.5 | 23.5 | 23.3 | 23.1 | 27.9 | 25.4 | 31.2 | 32.2 | 31.7 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Gross financing needs-to-GDP | 5.6 | 8.9 | 11.4 | 8.6 | 9.4 | 10.0 | 10.0 | 10.7 | 9.5 | 8.2 |
| Gross financing needs-to-revenue | 24.7 | 35.9 | 45.8 | 33.2 | 40.3 | 43.7 | 41.2 | 43.1 | 38.8 | 33.3 |

Source: Government of Tunisia, IMF for debt, IMF and World Bank staff projections

**Table 4.2: Key Assumptions Underlying Shock Scenarios**

| **Key assumptions underlying shocks (in %)** | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|
| | | | | |
| **Baseline Scenario** | | | | |
| Real GDP growth | 2.3 | 3.0 | 3.5 | 4.1 |
| Inflation | 5.3 | 4.3 | 3.8 | 3.6 |
| Primary Balance | -3.7 | -2.9 | -1.6 | -0.4 |
| Effective interest rate | 3.5 | 4.4 | 4.6 | 4.8 |
| | | | | |
| **Primary Balance Shock** | | | | |
| Real GDP growth | 2.3 | 3.0 | 3.5 | 4.1 |
| Inflation | 5.3 | 4.3 | 3.8 | 3.6 |
| Primary balance | -3.7 | -4.1 | -2.8 | -0.4 |
| Effective interest rate | 3.5 | 4.4 | 4.6 | 4.9 |
| | | | | |
| **Real Interest Rate Shock** | | | | |
| Real GDP growth | 2.3 | 3.0 | 3.5 | 4.1 |
| Inflation | 5.3 | 4.3 | 3.8 | 3.6 |
| Primary balance | -3.7 | -2.9 | -1.6 | -0.4 |
| Effective interest rate | 3.5 | 4.4 | 4.9 | 5.4 |
| | | | | |
| **Combined Shock** | | | | |
| Real GDP growth | 2.3 | 0.8 | 1.3 | 4.1 |
| Inflation | 5.3 | 3.7 | 3.3 | 3.6 |
| Primary balance | -3.7 | -4.1 | -3.0 | -0.4 |
| Effective interest rate | 3.5 | 5.0 | 4.9 | 5.5 |
| | | | | |
| **Real GDP Growth Shock** | | | | |
| Real GDP growth | 2.3 | 0.8 | 1.3 | 4.1 |
| Inflation | 5.3 | 3.7 | 3.3 | 3.6 |
| Primary balance | -3.7 | -3.7 | -3.0 | -0.4 |

| | | | | |
|---|---|---|---|---|
| Effective interest rate | 3.5 | 4.4 | 4.6 | 4.9 |
| | | | | |
| **Real Exchange Rate Shock** | | | | |
| Real GDP growth | 2.3 | 3.0 | 3.5 | 4.1 |
| Inflation | 5.3 | 8.6 | 3.8 | 3.6 |
| Primary balance | -3.7 | -2.9 | -1.6 | -0.4 |
| Effective interest rate | 3.5 | 5.0 | 4.6 | 4.8 |
| | | | | |
| **Contingent Liability Shock** | | | | |
| Real GDP growth | 2.3 | 0.8 | 1.3 | 4.1 |
| Inflation | 5.3 | 3.7 | 3.3 | 3.6 |
| Primary Balance | -3.7 | -12.5 | -1.6 | -0.4 |
| Effective interest rate | 3.5 | 4.8 | 5.1 | 5.3 |
| **Historical Scenario** | | | | |
| Real GDP growth | 2.3 | 2.5 | 2.5 | 2.5 |
| Inflation | 5.3 | 4.3 | 3.8 | 3.6 |
| Primary Balance | -3.7 | -1.8 | -1.8 | -1.8 |
| Effective interest rate | 3.5 | 4.4 | 4.5 | 4.8 |

Source: Government of Tunisia, IMF for debt, IMF and World Bank staff projections

**Table 4.3: Key Debt and Fiscal Indicators under Shock Scenarios**

| **Baseline** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** |
|---|---|---|---|---|---|---|
| Nominal Debt (in percent of GDP) | 57.2 | 62.9 | 68.9 | 71.7 | 71.2 | 69.4 |
| Debt Service (in percent of GDP) | 6.4 | 6.4 | 6.2 | 7.7 | 7.9 | 7.8 |
| Gross Financing Need (in percent of GDP) | 10.4 | 10.0 | 10.0 | 10.7 | 9.5 | 8.2 |
| Nominal Debt (in percent of Revenue) | 242.4 | 275.9 | 283.5 | 290.2 | 290.4 | 281.9 |
| Debt Service (in percent of Revenue) | 27.1 | 27.9 | 25.4 | 31.2 | 32.2 | 31.7 |
| Gross Financing Need (in percent of Revenue) | 44.0 | 43.7 | 41.2 | 43.1 | 38.8 | 33.3 |
| Real GDP growth (in percent) | 1.1 | 1.0 | 2.3 | 3.0 | 3.5 | 4.1 |
| Inflation (in percent) | 3.6 | 5.7 | 5.3 | 4.3 | 3.8 | 3.6 |
| Primary Balance (in percent of GDP) | -4.0 | -3.6 | -3.7 | -2.9 | -1.6 | -0.4 |
| Effective Interest Rate (in percent) | 4.8 | 4.5 | 3.5 | 4.4 | 4.6 | 4.8 |
| **Real Exchange Rate Shock** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** |
| Nominal Debt (in percent of GDP) | | | 68.9 | 76.7 | 76.1 | 74.1 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Debt Service (in percent of GDP) | | | 6.2 | 8.5 | 8.5 | 8.3 |
| Gross Financing Need (in percent of GDP) | | | 10.0 | 11.4 | 10.1 | 8.7 |
| Nominal Debt (in percent of Revenue) | | | 283.5 | 310.5 | 310.4 | 301.4 |
| Debt Service (in percent of Revenue) | | | 25.4 | 34.3 | 34.6 | 33.9 |
| Gross Financing Need (in percent of Revenue) | | | 41.2 | 46.2 | 41.1 | 35.5 |
| Real GDP growth (in percent) | | | 2.3 | 3.0 | 3.5 | 4.1 |
| Inflation (in percent) | | | 5.3 | 8.6 | 3.8 | 3.6 |
| Primary Balance (in percent of GDP) | | | -3.7 | -2.9 | -1.6 | -0.4 |
| Effective Interest Rate (in percent) | | | 3.5 | 5.0 | 4.6 | 4.8 |
| **Combined shock** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** |
| Nominal Debt (in percent of GDP) | | | 68.9 | 83.0 | 86.1 | 84.4 |
| Debt Service (in percent of GDP) | | | 6.2 | 9.1 | 9.7 | 9.9 |
| Gross Financing Need (in percent of GDP) | | | 10.0 | 13.2 | 12.7 | 10.3 |
| Nominal Debt (in percent of Revenue) | | | 283.5 | 336.2 | 351.6 | 343.2 |
| Debt Service (in percent of Revenue) | | | 25.4 | 36.7 | 39.5 | 40.1 |
| Gross Financing Need (in percent of Revenue) | | | 41.2 | 53.3 | 52.0 | 41.7 |
| Real GDP growth (in percent) | | | 2.3 | 0.8 | 1.3 | 4.1 |
| Inflation (in percent) | | | 5.3 | 3.7 | 3.3 | 3.6 |
| Primary Balance (in percent of GDP) | | | -3.7 | -4.1 | -3.0 | -0.4 |
| Effective Interest Rate (in percent) | | | 3.5 | 5.0 | 4.9 | 5.5 |
| **Contingent Liability shock** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** |
| Nominal Debt (in percent of GDP) | | | 68.9 | 83.4 | 85.1 | 83.3 |
| Debt Service (in percent of GDP) | | | 6.2 | 8.4 | 9.7 | 9.1 |
| Gross Financing Need (in percent of GDP) | | | 10.0 | 20.9 | 11.3 | 9.5 |
| Nominal Debt (in percent of Revenue) | | | 283.5 | 337.5 | 347.5 | 338.6 |
| Debt Service (in percent of Revenue) | | | 25.4 | 34.0 | 39.7 | 37.1 |
| Gross Financing Need (in percent of Revenue) | | | 41.2 | 84.7 | 46.3 | 38.7 |
| Real GDP growth (in percent) | | | 2.3 | 0.8 | 1.3 | 4.1 |
| Inflation (in percent) | | | 5.3 | 3.7 | 3.3 | 3.6 |
| Primary Balance (in percent of GDP) | | | -3.7 | -12.5 | -1.6 | -0.4 |
| Effective Interest Rate (in percent) | | | 3.5 | 4.8 | 5.1 | 5.3 |

Source: Government of Tunisia, IMF for debt, and World Bank staff projections

## ANNEX 5: ENVIRONMENT AND POVERTY / SOCIAL ANALYSIS

| Prior actions | Significant positive or negative environment effects (yes/no/to be determined) | Significant poverty, social or distributional effects positive or negative (yes/no/to be determined) |
|---|---|---|
| **Improving the business environment** | | |
| Prior action #1: The four implementing decrees of the new Competition Law No. 2015-36 dated September 15, 2015-Decree No. 2016-780 dated June 13, 2016, Decree No. 2016-1148 dated August 19, 2016. Decree No. 2016-1204 dated October 18, 2016, and Decree No. 2017-252 dated February 8, 2017- have been published in the Official Gazette No. 51 dated June 24, 2016, the Official Gazette No. 72 dated September 2, 2016, the Official Gazette No. 87 dated October 25, 2016, and the Official Gazette No. 13 dated February 14, 2017, respectively. | Adverse environmental impacts are not expected. | Adverse poverty and social impacts are not expected. Improved competition would improve product and service quality and reduce prices. The effect of more competition on net job creation could be negative in the very short-term as less competitive firms shed jobs but additional jobs created by new entrants and more productive firms could dominate this effect especially in the medium-term. |
| Prior action #2: The new Investment Law No. 2016-71 dated September 30, 2016, reinforcing the rights and guarantees of investors and market access regulation, and its implementing decree, Decree No. 2017-390 dated March 9, 2017, establishing the unit at the Ministry of Development, Investment and International Cooperation responsible for streamlining investment entry authorizations, have been published in the Official Gazette No. 82 dated October 7, 2016 and the Official Gazette No. 25 dated March 28, 2017, respectively. | Adverse environmental impacts are not expected. Higher investment and economic activity could be accompanied by negative environmental impact in some sectors. At the same time higher investment in some sectors such as renewable energy, a priority sector for Tunisia, could improve energy mix and have positive environmental spillovers for other sectors of the economy. | Adverse poverty and social impacts are not expected. It is expected that there will be higher job creation stemming from more investment and firm creation. |
| Prior action #3: The Decree No. 2017-394 dated March 29, 2017, establishing a unified public investment management framework for public investment projects (PIP) and public private partnership (PPP) projects to cover the appraisal, selection and prioritization, financing modalities and continuous monitoring of all investment projects has been published in the Official Gazette No. 26 dated March 31, 2017. | Adverse environmental impacts are not expected. Compliance with environmental safeguards will be taken into account during project appraisal and selection and should be assessed and monitored during project implementation to minimize potential negative impact. | Adverse poverty and social impacts are not expected. Improved allocation (equity) and efficiency of public investment will have positive poverty reduction impact. |

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| Prior action #4: The Minister of Finance and the Minister of Transport have issued Circular No. 86 dated November 14, 2016, replacing Circular No. 19 dated March 30, 2011, to introduce the digitization of remaining port procedures. Circular No. 86 has been published on the website of the Ministry of Finance. | Adverse environmental impacts are not expected. | Adverse poverty and social impacts are not expected. More efficient port procedures could translate into lower prices of imported goods. |
| Supporting Entrepreneurship and Deepening Access to Finance | | |
| Prior action #5: The Council of Ministers has approved on April 28, 2017, and the Head of Government has transmitted to Parliament on May 2, 2017, the draft Seed and Equity Code (Code des Organismes d'Investissment Collectif) enhancing access to finance of young firms and entrepreneurs. | Adverse environmental impacts are not expected. Higher investment and economic activity could be accompanied by negative environmental impact in some sectors. At the same time higher investment in some sectors such as renewable energy, and in innovative startups could have positive environmental spillovers for other sectors of the economy. | Adverse poverty and social impacts are not expected. It is expected that there will be faster firm and job creation stemming more equity and seed financing. |
| Prior action #6: The Council of Ministers has approved on February 24, 2017 and the Head of Government has transmitted to Parliament on February 27, 2017, the draft Law (loi organique) on Credit Bureau improving credit information and promoting access to credit for young MSMEs and entrepreneurs. | Adverse environmental impacts are not expected. | Adverse poverty and social impacts are not expected. It is expected that better risk assessment following the creation of private credit bureau will improve risk-adjusted interest rate and contribute to reduced risk of over-indebtedness. |
| Prior action #7: The new Law of Collective ProceduresNo. 2016-36 dated April 29 2016, simplifying Tunisia's bankruptcy regime has been published in the Official Gazette No. 38 dated May 10 2016. | Adverse environmental impacts are not expected. | Adverse poverty and social impacts are not expected. |

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| Prior action #8: To improve households' access to housing finance, the Decree No. 2016-1126 dated August 18, 2016, revising the eligibility criteria of the Social Housing Promotion Fund (FOPROLOS or Fonds de Promotion du Logement pour les Salariés) has been published in the Official Gazette No. 71 dated August 30, 2016. | Adverse environmental impacts are not expected. | Adverse poverty and social impacts are not expected. It is expected that improved access to housing will improve household wellbeing, collateral and access to finance. The creation of private credit will help reduce the risk of over-indebtedness. |