Document of

The World Bank

TUNISIA URBAN DEVELOPMENT AND LOCAL GOVERNANCE PROGRAM

Technical Assessment Report

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A. Program Description

Government program

1. The government program consists of state financial support to municipal infrastructure delivery and institutional strengthening covering 264 municipalities (local governments - LGs) for the period 2014-2019. Through this program, the government intends to shift from a purely "infrastructure delivery" approach to more focus on LG performance and accountability. To this end, the government's program aims at: (i) strengthening LG institutional capabilities while transforming their relationship with their citizens through measures that are designed to foster transparency, participation and accountability; and (ii) improving municipal infrastructure delivery with special attention to disadvantaged communities.

2. In this context, the reform of the LG capital grants and municipal investment planning framework forms the main strategic actions undertaken by the government towards the implementation of its decentralization agenda recently anchored in the new Constitution adopted in January 2014. This grant system, which had operated under an ex ante system of controls, is being restructured through the revision of the Decree 97-1135 governing the LG capital grant system. Through the restructuring, the government intends to improve the efficiency of the state financial support to municipal investment, make the allocation of capital grants more transparent and predictable, strengthen the decision-making power of LGs on the use of their investment funding, and progressively introduce a performance based dimension to their capital grant system. Along with revision of the above decree, the government has also issued a Ministerial Decree to introduce participatory municipal investment planning and budgeting systems, hence promoting citizen engagement in identifying investment needs and priorities. Under the same reform, the government will progressively introduce an independent, annual assessment to measure the performance of LGs in line with the above amended decree.

3. The performance assessment system, in addition to serving as a tool for monitoring LG's performance, has proven to be a very effective means of incentivizing LGs to strengthen their institutional performance, where access to grant funds is linked to results. The areas covered under the performance assessment will include governance, sustainability and management. The results of this performance assessment will be used to adjust the capital grant allocation starting the third year of the program.

4. The government program consists of three sub-programs, namely:

- Subprogram 1: Municipal infrastructure delivery;
- Subprogram 2: Improving access to basic municipal infrastructure in disadvantaged neighborhoods;
- Subprogram 3: Capacity support for improved LG institutional development and accountability.

Subprogram 1: Municipal infrastructure delivery (US$591 million)

5. Consistent with past practice under the municipal investment program – the Program des Investissements Commun (PIC), the subprogram involves the preparation of five-year investment plans for each LG to deliver municipal infrastructure, underpinned by capital resources derived from three sources: (i) local government contribution; (ii) capital grants from central government; and (iii) investment loans provided by the Caisse des Prets et de Soutien

aux Collectivites Locales (the Caisse - - CPSCL), which is also taked with managing capitalmgrant transfers form the center to the LGs. In addition, LGs receive capacity development and technical support to prepare and implement their plans via training programs offered by the Centre de Formation and Appui à la Decentralisation (CFAD – see para 47) and technical assistance from regional offices of the CPSCL and line agencies of central government, as well as through local consultancy services. This sub-program will entail the following activities:

6. **Capital Block Grants for Municipal Infrastructure Delivery (USD203 million).** The use of capital grants for municipal infrastructure delivery is determined solely at the discretion of each LG (without any ex ante control), subject to its being used for municipal infrastructure investments that fall within the mandates of the LGs. The the Capital Block Grant or performance based grants (PBGs) to LGs for capital investments will be allocated according to a formula and the use of the grant resources will be determined solely at the discretion of each LG (without any ex ante controls). The PBGs, which will be reflected in the LGs' PICs (their 5-year indicative investment programs), and their detailed annual investment plans, and will conform to municipal infrastructure (works and equipment, including engineering studies and supervision costs) that fall within the mandate of LGs. The grant will be administered by the CPSCL (on behalf of the state) and validated through a participatory planning and budgeting approach. The LGs will be responsible for planning and implementing the sub-projects comprising their investment plans and financed either in toto by the PBG, or in combination with other sources of funds. The PBG funds will be reflected in the revenues and expenditures of the LGs' annual budgets, with the resultant assets incorporated into their asset registers. Sub-project implementation will be undertaken by LGs with the support, if needed, of private sector consultancy services.

7. The PBG will function according to the following principles: (a) a PIC whereby each LG is allocated an indicative envelope of resources available to it, according to an allocation formula, for capital investments over a five year period, to be transferred annually at the beginning of each FY; (b) the allocation formula is to be made public, as are the annual allocations to each LG; (c) the allocation formula is built around objective, measurable criteria that also include equalization considerations; (d) use of the funds is discretionary to the receiving LG and is not subject to ex ante review by central agencies; (e) access to the funds, which can be integrated with other untied LG revenues at the local level, is not tied to other parallel fiscal or financial instruments; (f) LG performance is assessed annually, ex post, by an independent evaluator, whose findings are made public and are presented comparatively across all LGs; and (g) performance assessment criteria cover three areas: (1) **Governance**, comprising consideration of: (i) participatory planning and budgeting; (ii) transparency in LG operations (access to information regarding: capital expenditures/consistency with budget, contract awards, investment implementation progress, financial statements/audits); (iii) procurement (timeliness, efficiency and in accordance with regulations); (iv) safeguards (planning and implementation procedures) and (v) response to complaints; (2) **Sustainability**, including: (i) asset inventory in place, asset management including O&M plans established annually and implemented; (ii) where required, financial recovery plans (FRPs) prepared and being implemented; (iii) own source revenue collection enhancement plans prepared and being implemented; and (iv) preparation and implementation of capacity building plans; and (3) **Management** addressing: investment implementation, financial accounting practices and satisfactory audits.

8. The total unconditional capital grants for municipal infrastructure amount to US$ 5.7 per capita/year. Key investment activities under the Program are presented in Annex 5 (and include road construction, rehabilitation and upgrading, urban drainage, sewerage and other

environmental improvements, solid waste collection and street cleaning, parks and some recreation facilities, and markets) and Annex 1 sets out a detailed description of the Program.

9. **Local Government Contribution (US$129 million).** In parallel with the above capital grants, the government's 2014-2019 PIC envisages increasing levels of LG contributions towards investments in municipal infrastructure. The Government recognizes that reforming the own source revenue system will take time as it involves major policy changes, and is therefore focusing on opportunities for improving local revenue collection rates within existing tax and fee regimes.

10. **Municipal Investment Loans (US$259 million):** In addition, LGs capable of borrowing will have access to the CPSCL credit line as a potential funding source to implement their PICs. The Loans from the CPSCL serve to maximize leverage on resources available to LGs for investing in municipal infrastructure. In parallel, the government is introducing reforms under the Decree and in the CPSCL lending guidelines in order to ensure rigorous lending practices that establish a balance for LGs between maximizing their borrowings and improving their financial viability, as well as ensuring the stability of the CPSCL.

Subprogram 2: Access to municipal basic infrastructure in disadvantaged neighborhoods (US$150 million)

11. Under this subprogram, the government will provide targeted/conditional grants directed towards investments that represent national policy priorities (in this case, for the new PIC period, to improve access to municipal services in disadvantaged neighborhoods).

12. Activities under the subprogram will include consultancy services (including feasibility and engineering studies, and support to implementation services) and civil works for the provision of basic infrastructure such as roads and paving, street lighting, sewerage extension/connection to the public network, and storm water drainage in selected disadvantaged neighborhoods located in 114 municipalities.

13. Tunisia has been implementing, since 1992, national programs targeting the upgrading of disadvantaged neighborhoods with the provision of basic municipal infrastructure (PNRQP). However, most urban upgrading sub-projects were identified and prioritized by the center and implemented by the *Agence de Rehabilitation et de Renovation Urbaine* (ARRU,), a dedicated national agency. The LGs were merely consulted but had to co-finance up to 30% of the total cost outnof their own resources.

14. The new approach will introduce reforms that address, in particular: (i) full ownership and responsibility of LGs in preparing and implementing the related investments as part of their municipal investment programs; (ii) credible consultative and participatory approaches for neighborhood identification/selection and for neighborhood determination of priority investment needs; (iii) 100% grant funded in order to avoid exerting additional financial stress on LGs responding to centrally determined priorities; and (iv) provision of just in time support to LG to implement sub-projects and concurrently deepen their capacity to prepare more complex investment programs.

15. The conditional grant allocation over the program period amounts to USD 142 million or an average of about USD 1 million per LG which represents around 284 US$/beneficiary (1420 US$/HH).

Subprogram 3: Capacity support for improved LG institutional development and accountability (US$10 million)

16. The government's program upgrades the system of capacity support for LGs in order for them to achieve improved institutional performance targets. The capacity support program would contribute to the LGs ability to achieve the standards required under the performance assessment system to help them access their full entitlement to capital grants.

PforR Program (Program)

17. The Program (described in detail in Annex 1) will support those elements of the government program that focus on capital grants for municipal infrastructure delivery and related institutional and capacity building. It will be implemented through the 2014-2019 period and will finance activities in the same geographical areas (the Program Area) covered by the Government Program: all 264 municipalities (LGs), plus any new ones that may be constituted during Program implementation.

18. Table 1 below presents the Program (gray shaded cells) vis-à-vis the Government program.

Table 1: Government's program and PforR Program Scope

<table>
<tr><td>Subprogram 1
Municipal infrastructure delivery
TND 887 million (US$591 million)</td><td>Subprogram 2
Improving access to municipal infrastructure in disadvantaged neighborhoods
TND 225 million (US$150 million)</td><td>Subprogram 3
Capacity support for improved LG institutional development and accountability
TND 15 million (US$10 million)</td></tr>
<tr><td>Capital Block Grants TND 305 million (US$203 million)
Formula-based grant allocation to LGs subject to their meeting annual Minimum Mandatory Conditions (MMCs) and achieving satisfactory annual performance scores.</td><td rowspan="3">Conditional Capital Grants TND 225 million (US$150 million)
Grant allocation to LGs for specified investments in line with national priorities (currently for local infrastructure in disadvantaged neighborhoods), subject to their meeting a Minimum Mandatory Condition (MMC) grant access requirement.</td><td rowspan="3">Capacity-building and technical support TND 15 million (US$10 million)
Demand-based capacity support to be provided to LGs on a just-in-time basis.</td></tr>
<tr><td>LG Contribution
TND 193 million (estimate)
LGs Contribution to the investments from their net savings.</td></tr>
<tr><td>Municipal investment loans
TND 389 million (estimate)
Investment loans to LGs from CPSCL.</td></tr>
</table>

19. The development objective of the Program is: (i) to strengthen Local Governments' institutional performance to be better able to deliver municipal infrastructure, and (ii) to improve access to services in targeted disadvantaged neighborhoods.

20. Based on the need identified during the preparation of the proposed program and to provide targeted selectivity for Bank support, the Program encompasses three primary activities: (a) performance-based capital grants for municipal infrastructure delivery; (b) targeted capital grant for improving access to basic municipal service in disadvantaged neighborhoods; and (c) capacity support for improved LG institutional development.

A. Capital Block Grants for Municipal Infrastructure

21. The grants would be performance-based to incentivize LGs to achieve improved levels of institutional capacity in key areas of their municipal functions. The target would be for 60% of LGs to achieve threshold scores (levels to be determined during finalization of the performance assessment manual) or more on their performance evaluation by the fifth year of the Program. To achieve the targeted outcomes, the Program provides resources under the PBG sub-window for investments in local infrastructure services, with funding levels modulated by each LG's ability to meet annual performance standards applicable to unconditional grants as measured by annual Minimum Mandatory Conditions (MMCs) and Performance Assessments (PAs) undertaken according to agreed criteria.

22. Under the Program, 264 municipalities will receive performance-based grants from the State, transferred through the CPSCL (the administering authority) to support priority investments in urban infrastructure that have been identified by the LGs and reflected in their participatory 5-year and annual municipal investment plans. The municipalities will be responsible for planning and implementing sub-projects financed with performance-based grant funds, and grant funds will be reflected in the revenues and expenditures of their annual budgets.

23. Performance-based grants will be allocated to the municipalities according to a transparent and predictable formula. These allocations are weighted by LG population and fiscal potential (80/20), subject to the application of an adjustment factor to ensure that each municipality will receive at least the equivalent of the envelope received during the previous PIC. These allocations provide an average annual allocation of USD5.7 per capita over the period of the Program (roughly consistent with levels under the previous PIC, although serving a slightly larger population universe).

24. These allocations are for planning purposes and the actual annual disbursement of funds will be made on the basis of: (i) each LG meeting the MMCs; and (ii) each LG's performance meeting minimum standards as measured against a set of criteria. Details regarding MMCs and PAs are included in Annex 1.

B. Targeted Capital Grants for Improving Access to Basic Municipal Service in Disadvantaged Neighborhoods

25. Resources under the conditional grant sub-window for investments in local infrastructure services in targeted disadvantaged neighborhoods, with funding levels

modulated by the participating LGs' ability to meet MMCs applicable to conditional grants that comprise the basic grant access element of the performance assessment system.

26. The conditional/targeted capital grant system represents a vehicle for the government to address policy priorities. Currently, government priority is focused on upgrading service levels in disadvantaged neighborhoods. A total of TDN 225 million has been allocated under the conditional grant for the PIC 2014-2019 period for this purpose. Due to resource constraints and the uneven distribution of disadvantaged neighborhoods across LGs in the country, a regional consultation process (involving elected officials, city representatives, civil society, deconcentrated agencies) was undertaken to pre-identify neighborhoods and LGs that would qualify to receive these grant funds during the FY2014-2019 cycle. LGs currently covered by ongoing urban upgrading programs are not targeted by the Program.

27. As a result of this regional consultation/selection process, 144 LGs comprising 229 neighborhoods have been pre-identified, and a preliminary estimate of infrastructure requirements, boundaries, number of households and costs has been established. To update these estimates and confirm their viability and scope, each participating LG will prepare a pre-feasibility study that will include participation of the affected communities, and will take into account the services to be improved, the size of the population and the level of poverty (requiring a brief survey), the levels and construction standards to be applied, the boundary of the selected neighborhoods, preliminary cost estimates, and the timeline for preparing and implementing the investments. Subject to the findings of the pre-feasibility studies, the LG councils will consider and, if approved, include the proposed investments within the framework of their annual investment plans and budgets.

28. The application of the performance system to the conditional grant is limited to the MMCs and then only on a one-time basis for the year when the construction of the approved upgrading plans is projected to commence.

C. Capacity support for improved LG institutional development and accountability

29. The capacity support program would contribute to the LGs ability to achieve the standards required under the performance assessment system in order for them to access their full entitlement to the capital grants. As Program Manager, the CPSCL in close coordination with the CFAD, will organize information, training and 'hands-on' technical assistance to municipalities. These activities will focus on the key support required to assist municipalities to achieve MMCs and performance criteria, and thus contribute to the achievement of the Program Development Objective.

30. Given the likely heterogeneous demand from municipalities, capacity and technical support will be provided based on an annual Capacity Development Plan, prepared by each LG, to address needs identified during a specific capacity needs assessment that was carried out during Program preparation. The four broad areas identified as requiring capacity building support at the city level include: (i) municipal participatory investment prioritization and planning; (ii) own source revenue enhancement; (iii) project quality, including procurement and environmental and social management; (iv) asset management systems and mechanisms for operations and maintenance; and (v) financial management systems and practices

31. The program will also support the introduction of several initiatives which will strengthen government's decentralization, participatory governance and transparency agenda

as established under the new Constitution. These initiatives include the design and launch of a new e-Platform (Portail des Collectivités Locales) which will make budget, procurement and audit information for all LGs as well as the results of LG performance assessments, accessible to the public. Progressively, the Portail will also host LGs' information on Participatory Planning and Participatory Budgeting processes.

B. Program Strategic Relevance

National Context

32. **Tunisia is currently going through a transitional phase of democratic and political reform**. In January 2011, the wave of protests that ended the 23-year rule of President Zine El Abidine Ben Ali, ushered in a new political, social and economic era. The revolution was fueled by widespread anger and frustration over lack of social and political inclusion, governance and corruption, mounting unemployment and the rising cost of living. Since then, Tunisia successfully held its first democratic elections for a National Constituent Assembly in October 2011.

33. Tunisia's political transition gained new momentum in early 2014, with the resolution of political deadlock, the adoption of a new Constitution and the appointment of a new government. The national dialogue platform, brokered by key civil society organizations, played a crucial role in gaining the participation of all major political parties. This resulted in the adoption of a consensus roadmap leading to general elections, planned for the end of 2014. Additionally, local elections (municipal and regional) are expected to be organized in 2015. The strategic direction that the new government embarked upon focuses on restoring and maintaining security, while laying the groundwork for a stronger economic recovery, as key to successfully completing the democratic transition.

34. **After a short-lived rebound in 2012, increasing political and social instability during 2013, as well as a difficult external environment, have led to a slowdown in economic growth.** Rebounding from the contraction of 1.9% of GDP in 2011, the economy grew by 3.6% in 2012, somewhat above expectations. For 2013, growth has been estimated to have slowed down to 2.6%, as agricultural production and the oil and gas sector have declined markedly, while manufacturing stagnated. Unemployment continued to decline to 15.3% at the end of 2013, from 16.7% one year earlier, but still well above the pre-revolution level of 13%. Post-revolutionary governments have pursued expansionary fiscal and monetary policies until 2013 in an effort to support economic recovery and employment. In 2013, the deficit had reached 6%. A tightening of monetary as well as more moderate commodity prices have allowed for a slowdown in consumer price inflation, which slowed to 5.5% in February 2014, after reaching 6.3% in 2013.

35. **Although poverty has been nearly halved in Tunisia between 2000 and 2010 and the country performed well in terms of a range of social indicators, regional disparities saw poverty rates in excess of 30% in some parts of the country,** and high unemployment has been a major driver of the 2011 revolution, particularly amongst youth, who failed to reap the benefits of relatively buoyant growth. With respect to gender equality and women's rights, while Tunisia is one of the more advanced countries in the region, underutilization of skilled women in the labor market remains a concern, and addressing women's rights more generally represents a key governance issue. In the short-term, government's main challenge is to ensure social peace and security as a prerequisite for restoring economic activity and putting the economy back onto a growth trajectory. The government is also seeking to establish an enabling environment for structural reforms that, among other objectives, would reduce

unemployment and regional disparities, address governance, and improve living conditions throughout the country.

36. **Today, Tunisian policymakers are rethinking the relationship between central and local governments (LGs), and have taken concrete steps towards a more decentralized system**. Since the January 2011 Revolution, Tunisia has signaled its intent to bring cities into the heart of the local development process, making them proactive players in planning, implementing and delivering municipal infrastructure and services. There is widespread recognition that LGs, with their elected municipal councils and mayors, must be more than "passive spectators" in urban development. Moreover, there is a general consensus that, if they are to play a greater role, LGs need to become more transparent and accountable to local citizens.

37. **The New Constitution promulgated on Jan 27, 2014, includes clear commitments to decentralization** and proposes fully devolved and empowered LGs with autonomy for executing their mandates of providing local services according to transparent principles of participation by, and accountability to, their citizens. The changes mandated by the Constitution regarding local governance are transformational, as they effectively reverse the highly centralized previous structure, whereby central oversight and approval ("*tutelle*") was exercised on all facets of local government accountability, decision-making, and capital works and service delivery-related investments. The Constitution recognizes the decentralization processes as the fundamental basis for the organization and distribution of power in Tunisia, and as an essential step to achieve a more efficient administration closer to its citizens. The first article dedicated to LGs states that "local power is based on decentralization" (Chapter VII, Article 131). It further states that LGs (particularly municipalities and regional governments) are chosen by universal, free and transparent vote, and will have their own legal personality, together with administrative and financial independence.

Strategic Relevance

38. In order to introduce policies that firmly ground voice and accountability into the governance structure of the country, in response to the Revolution of 2011 and the provisions of the new Constitution, transformational changes to the operating framework of local government are required, and the Program is designed to support key reforms necessary to restructure the institutional and fiscal framework to more effectively address the decentralization provisions contained in the Constitution. The reforms pose several challenges to the existing structures of local government, most notably, in light of the greater municipal autonomy mandated in the Constitution, the need to: strengthen the LGs to be better able to perform their essential functions of citizen consultation and accountable service delivery independently of central intervention; revamp the existing oversight system (tutelle) from one of central government controls, clearances and approvals for local investment decision-making, to one of central support, capacity strengthening and policy reform for local governments to be better able to undertake their mandates; and address several key provisions of current regulatory requirements in the operation of local governments, particularly regarding the fiscal architecture of inter-governmental transfers, that have proven counter-productive and have fostered outcomes contrary to those intended by the policies in place.

39. **The Program design consequently has high strategic relevance for Tunisia's development.** It is calibrated to introduce the reforms in a manner recognizing: (a) that the transition to an effectively functioning decentralization system of fully-devolved local government will take time, (b) that builds on existing systems, taking advantage of existing strengths, but (c) introduces the changes to the fiscal architecture and regulatory framework

necessary to directly translate the Constitutional mandate into practice in areas that offer prospects for early wins and establish the core elements of viable and accountable local governance. The restructuring therefore is carefully sequenced to focus on those actions that, on the one hand will have transformative consequences, and introduce sustainable systems and practices, while on the other hand are phased in according to graduated reforms that are practical and can be implemented in the short term to have immediate impact on addressing key provisions under the Constitution.

40. **Analysis of existing regulatory systems and procedures, and institutional structures suggests that reforms to the capital grant will introduce significant advances towards accountable local governance and better capacitated local governments, constituting an effective first phase to the broader decentralization agenda established under the Constitution**. The Program therefore will operate within the existing fiscal architecture by restructuring the existing capital grant window for transferring resources to municipalities from a system that is regulated by centrally determined and opaque allocation procedures and investment priorities, into a window regulated by a system of resource transfers made according to: (a) a formula based unconditional capital grant system for uses determined fully at the discretion of the LGs, with disbursements subject to annual LG performance assessments; and (b) a conditional grant system managed by the LGs but for investment purposes deemed to be national policy priorities.

41. The formula based unconditional grant system is designed to address the following issues considered central to meeting the mandate of the new Constitution: (a) allocative equity, objectivity, and transparency; (b) greater voice for citizens in the operational and service delivery responsibilities of their local governments through: (i) citizen consultation by local governments in the use of the discretionary grant funds, and (ii) increased accountability of the local governments to their citizens through timely access to relevant information about local government performance; (c) effective incentives, through grant access requirements, that encourage LGs to perform better along key parameters essential to enhancing their accountability to their citizens and strengthening their planning, fiduciary and operating capabilities; and (d) measuring the performance of the LGs in meeting the grant access requirements through an annual, ex post, independent assessment system, rather than the current ex ante tutelle system.

42. In order to capture these reforms, Program preparation and implementation supports the revision and operationalization of Decree 97-1135 that governs and regulates the fiscal system for LG in the country. It also is designed to underpin and function within the government's well-established PIC system of resource transfers and LG service delivery. The Program also conforms with the World Banks' Country Interim Strategy Note (ISN) for Tunisia for 2013-2014. The ISN spells out a set of three broad areas for Bank engagement and, within those areas, a number of driving objectives (DOs) that the Bank will pursue. The proposed operation is fully aligned with the ISN's second area of engagement: promoting social and economic inclusion. Within this second area, the operation addresses DO 5, improving access to basic services for under-served communities. About half a million people or 8% of the urban population living in disadvantaged neighborhoods are targeted through the proposed program. The proposed operation is also generally in line with the ISN's third area of engagement: strengthening governance through voice, transparency and accountability. The operation's focus on local governance institutions, decentralization, and significantly strengthening participatory democracy at Local Government level directly supports this.

C. Technical soundness

43. **The Program development objective is to improve institutional performance of LGs in the context of the reform initiatives introduced by the government as a vehicle towards establishing fully decentralized local government.** The Program is designed to meet this objective and is technically sound, drawing on international best practice and integrating it with the specific circumstances of the Tunisian reform initiative. In particular, consistent with the government's policy of phasing its program of decentralization reform, the Program utilizes fiscal instruments to effectuate the initial round of reforms in the following manner:

44. ***The Program conforms to principles core to operating an effective fiscal decentralization framework, including***:

- *Linking the transfer of grant resources to improvements in LG performance in those areas of LG operations considered as the most important functions for strengthening their institutional capabilities.* These linkages, when supported by appropriate access to technical assistance measures, have demonstrated the effectiveness of using financial incentives to leverage increased LG institutional capacity. The unconditional grant under the Program is structured around this principle of performance-based allocation of grant funds, and is designed to be phased in, in order to take account of local circumstances;

- *Operating within the existing fiscal architecture, regulatory regimes, and institutional systems*; under the Program the current grant window will be restructured into two sub-windows, one unconditional, the other conditional, each with clear operating procedures; the regulatory framework for operating the grants remains governed by Decree 97-1135, but substantially restructured to align with the reforms; and the institutional arrangements such as the PIC cycle and the role of the CPSCL in managing the transfer process, with their well-established systems and capabilities, are maintained, adjusted to take account of processes that operate on ex post rather than ex ante oversight, but with all the other well-established and effective procedures such as fund flows and procurement practices intact.

45. ***The Program is built around two design elements that draw on international best practice, but are tailored to the policy reform environment in Tunisia****:*

- *All 264 entities that are formally designated as municipalities (LGs) in Tunisia will participate in the Program*. The justification for this broadly inclusive approach is derived from the assessment that clearly demonstrates: (i) absorptive capacity of the LGs, (ii) management and administrative capacity of the Caisse, (iii) soundness of the primary planning vehicle (the PIC), and (iv) the robustness of key operating systems such as procurement practices. In addition, the size of the resource transfers will remain consistent with past allocation levels. Consequently, the delta will not be managing major grant increases, but adjusting to the reforms which, most notably, are: the change in responsibility and accountability for selecting and implementing investment choices, and improving essential operating capabilities. To this end, the performance assessment system will be introduced incrementally, and the capacity support system will be substantially expanded and deepened;

- *The size of the unconditional capital grant has to be sufficient to incentivize LGs to seek access to it, and therefore be motivated to improve their performance.* While the

size of the grants will only increase within the normal range that has characterized prior PIC increases, the incentives lie in three areas: (i) they are the primary capital development funds available to most LGs, and they are in the form of unconditional grants; (ii) they will now be available as entirely discretionary funds to the LGs, and their use will be fully determined by the LGs; (iii) the effectiveness of their use (and the ability of the LG to continue to access them) will be based on measurement of the LGs' performance by an independent agency, with the results made available to the citizens of each LG; and (iv) these funds are sufficient to allow for significant levels of investment in pressing local infrastructure priorities that fall within the functional mandates of the LGs;

46. ***The design directly addresses key features of the existing system that either embed the tutelle system, or over time have had increasingly perverse effects (and all these features are incorporated into the revised Decree).***

- *The system for allocating grants has not been transparent*. Under the Program, a formula has been introduced that is based on considerations of distributive equity (population has been used for this), and redistributive considerations as measured by fiscal capacity – a proxy for the strength of the economic base (poverty, social indicators, and unequal access to services were all considered, but data was poor). Data for the formula are derived from two independent sources – National Bureau of Statistics and the Ministry of Economy and Finance (MoEF) - ,and are both measurable and objective. The formula assigns 80% to population and 20% to fiscal capacity;

- *Grant access requirements under the previous version of the Decree that linked the use of grant funds to requirement to utilize loan funds in predetermined ratios have led to serious levels of fiscal stress* in nearly half the LGs. Under the reforms, these linkages have been terminated and the use of grant funds is subject only to council decisions on their investment priorities (Annex 2 describes the financial status of the LGs);

- *The prior linkage of grants to loans led to the well-endowed LGs being increasingly favored* as measured by the disproportionate per capita share of the grants they were able to garner, exacerbating regional disparities. The delinking, combined with the allocation formula addresses this issue directly, while still allowing the better-off LGs access to the loan funds to the maximum extent of their capacity to borrow;

- *The grant system undermined accountability of LGs to their citizens.* With opaque allocation criteria and decisions on investment priorities taken at the center, there has been little basis for the LGs to engage with their citizens, and no basis for the citizens to hold their councilors accountable, except on the margin for operating and maintaining existing assets. In addition there was no effective system for measuring LG performance, and no means of providing citizens with useful and timely information on their LGs' operations. Under the reforms, the objective and predictable flow of funds, and the unfettered responsibility of the LGs to determine the use of the funds creates the space for consultation and accountability to be introduced and for social contracts to be built between LGs and their citizens. The introduction of performance standards for LGs, together with systems for ensuring timely citizen access to information on their LG's performance, are also provided for in the Decree.

- *There has been no system for assessing and monitoring LG performance.* Under the Program, a system of performance requirements linked to grant access is being

introduced. The system will be phased and will start in year 1 with a set of minimum mandatory conditions (MMCs) that will be augmented in the third year by an annual independent performance assessment undertaken by the Controller-General of Public Services (CGSP). The findings will be published at the time of their completion each year and will be applied to regulate the level of disbursement of the grant funds to each LG according to their performance scores (to be detailed in the Performance Assessment Manual).

47. ***The Program creates a grant sub-window to channel funds on a systematic basis to government priority initiatives.*** Currently government runs a program that funds the provision of basic infrastructure service in disadvantaged neighborhoods. This program is operated by ARRU, which functions relatively independently of LGs. In addition, there are no clear guidelines on the process for targeting beneficiary LGs and selecting neighborhoods in any given year. The Program creates a conditional grant sub-window as a means of assisting the government to better align the upgrading program with its decentralization policy by systematizing the process whereby the LGs assume responsibility for defining and implementing investments in disadvantaged neighborhoods (the LGs that have qualified to receive funds under the Program are listed in Annex 6). The immediate impact of this change under the Program is that the process of consultation with affected communities is enhanced and the level of ex post scrutiny in introduced by ensuring that key elements of the performance system are applied to the use of funds under this window. Over time, the new window will also give the government greater opportunity to introduce clear rules and guidelines to determine which LG proposals qualify the LGs to receive funds under the conditional grant window. International experience has shown that conditional grants that function according to clear eligibility criteria, and are within the framework of the government's policy objectives but operated under the responsibility of the LGs offer investment efficiency gains, enhance LG effectiveness and accountability, and contribute to establishing effective social contracts between the LGs and their citizens.

48. **The strategy under the Program of using the linkage of LG access to grant funds to leverage improvements in their institutional performance is underpinned by providing targeted capacity enhancement measures.** On the one hand, the uneven capacity of the LGs has the potential to undermine the effectiveness of the performance-based incentive system. On the other hand, linking the access of funds to performance serves as a powerful means of leveraging in LG utilization of capacity support systems. The Program has responded to this by providing for two areas of support. One is to strengthen existing curricula and training programs of CFAD, (for both elected officials and staff). The other is to establish cadres of technical experts in each of the CPSCL's regional offices with resources to contract in skills on a just-in-time basis to respond to on-the-job capacity support to LGs dealing with issues of planning, budgeting, financial management, revenue generation, asset management, environmental and social safeguards, and procurement issues. This approach has been selected for two reasons. First, because international experience has shown that approaches which offer this type of demand-responsive, timely assistance, addressing real-time needs, and which do so within the context of the day-to-day operations of the LGs, have proven particularly effective. And second, because the program will be managed through the CPSCL's six regional offices that have solid capacity and well established working relationships with the LGs within their regions.

49. Extensive discussions have been held with key stakeholders involved in the decentralization agenda and the development program, including the policy agencies and CPSCL, the primary implementing agency. In addition, the Program has been discussed with officials from a number of LGs and with the *Federation Nationale des Villes Tunisiennes*, the

formal organization representing LG in Tunisia, as well as in meetings held with different LGs during the preparation of the Program.

D. Institutional Arrangements

50. Taking into account the fiscal nature of the reforms introduced under the Program, the MoEF is responsible for the Program and consequently the activities under the Program are financed directly by the MoEF through its annual budget. The MoEF will be responsible for Program implementation and for all transfer of funds under the Program. This will include ensuring that Program resources are budgeted for and disbursed within the Program expenditure framework according to existing state budget procedures.

51. An Inter-Ministerial Committee (IMC) was established on August 5, 2013, to oversee coordination of the Program, and is chaired by the Minister in charge of Local Governments within the Ministry of Interior (MoI)[1]. The IMC meets bi-annually (plus exceptionally as needed), providing strategic leadership and general direction for overall implementation of the Program. It is supported by the DGCPL, which will serve as the Secretariat to the IMC. The IMC is responsible for sectoral coordination and for providing strategic leadership and general direction for the overall implementation of the Program.

52. The CPSCL is mandated under the Decree and according to the Law no. 37 dated May 14, 1975, to administer the capital grant transfers to the LGs. The process of the Capital Grant transfers will be detailed in the Program Operations Manual. The CPSCL will be responsible for coordination of day-to-day implementation of the Program and will facilitate the timely completion of inter-dependent functions to be performed by the several supporting agencies. Its responsibilities and functions in this regard, as well as those of the supporting agencies and the LGs will be detailed in the Program Operations Manual.

53. As the agency designated to coordinate day to day Program implementation, the CPSCL will ensure adequate reporting through: (i) day-to-day monitoring of implementation progress of the Program; (ii) Program reporting, including the annual midyear report and Program Progress Report; and (iii) preparing the Program Financial Statements, compiling them from municipal financial reporting, as well as from the financial reporting of the other supporting agencies.

54. The other national entities who will have guiding and supporting roles in the Program include: the Court of Auditors (*Cour des Comptes*), especially for the annual program audits and the annual external audit of municipalities; the Public Procurement Oversight Committee (*Haute Instance de la Commande Publique, HICOP)* which provides overall technical guidance on public procurement and monitors the compliance of procurement standards and practices; the Market Monitoring Committee *(Comité de Suivi et d'Enquete sur les Marchés, COSEM)* which receives pleas relating to public procurement and takes follow up action; the Controller General of Public Services *(Contrôleur Général des Services Publics, CGSP)* or any designated independent entity acceptable to the Bank which will be in charge of the annual and independent PA of the LGs; and the National Authority for Fighting Corruption *(Instance Nationale de Lutte contre la Corruption*) which will be responsible for the investigation of complaints, if any, on fraud and corruption relating to the Program.

[1] Membership of the IMC includes representatives from the following ministries and Governmental agencies: (i) Interior, (iii) Economy and Finance, (iv) Regional Development, (v) CPSCL, (vi) CFAD, (FNVT) and (vii) ARRU.

55. At the local level, LGs will plan and implement investments financed under the Program, building on the well-established systems and procedures developed during the last 20 years with support from the three previous Bank-funded Municipal Development Projects. As these LGs are the project owners for individual investment projects, funding from the grants will be reflected in the revenues and expenditures of the LG annual budgets. The LG will prepare the annual municipal investment plan for the Program, consolidated with the annual budget plan of the LG. The annual budget is discussed and approved by the municipal council and the annual municipal investment plan and the annual budget will be disclosed after adoption. The LG will be responsible for approval of feasibility studies and basic designs, detailed designs and cost estimates and procurement plans.

56. The LGs will ensure that their technical and administrative departments are adequately staffed and resourced and will outsource the supervision of their sub-project implementation to private or public entities when needed. Financial management, procurement and environmental and social management activities will be undertaken by LGs in accordance with enhanced Government procurement rules and procedures, including the preparation of: (i) annual investment plans; (ii) consultancy services terms of reference; (iii) feasibility studies, including necessary social and environmental impact assessments; (iv) detailed designs and cost estimates; (v) tender documents; and (vi) the annual procurement plans. LGs will also be responsible for: (i) all procurement actions including advertising, bid evaluation and award of contracts; (ii) contract administration and management; (iii) technical supervision; (iv) verification of contractor's claims for payment, and issuing payment instructions to the municipal treasury (*Receveur municipal)*; (v) monitoring and proper reporting of physical progress of investments; and (vi) ensuring assets are entered in the asset register of the LG on commissioning.

57. Municipalities require a wide range of expertise to successfully carry out their mandates. An analysis of staffing carried out as part of Program preparation reveals that most municipalities have the necessary staff, but all LGs are expected to have the necessary support from DGCPL, CFAD and CPSCL and consulting firms, as LGs that do not meet the minimum mandatory condition will not be able to access Program funds.

58. The CPSCL will be directly responsible, through its regional offices, for the execution of the technical assistance (just-in-time support) activities of the capacity-building program (as described above). The CFAD will be in charge of classroom-based training and the workshops to be held to familiarize the LGs and the central agencies with the Program activities and objectives. CFAD will be also in charge of developing and delivering additional training programs that target gaps in areas of LG responsibility that affect their performance and that may be identified during Program implementation, particularly those that emerge through the performance assessment system. The capacity support roles of CPSCL, CFAD, and the other agencies playing associated functions are summarized in Table 2 below.

Results Monitoring and Evaluation

59. The Results Framework (Annex 3) provides the basis on which the CPSCL, in close coordination with the LGs and supporting agencies, will appropriately measure and report on progress.

60. The CPSCL will prepare Program progress reports annually, as outlined in the Resuts Monitoring and Evaluation Framework elaboriated in the Program Operations Manual (POM). The report will include consolidated financial statements that will cover all Program activities, expenditures and sources of funds, implementation status, progress in achieving the DLIs,

result indictors, and evidence of compliance with requirements of the Program Action Plan. The POM will include the format and details of reporting.

Table 2: Capacity-Building Arrangements under the Program

Area of Support	Description	Supporting agencies	Timing
Formal LG Training	Formal training programs addressing the functioning of decentralization systems and the operational responsibilities of LGs, for both elected officials and staff;	CFAD	Formal system already operational
Technical Assistance to LGs	Program of on-the job, just-in-time assistance provided to LGs on a demand-driven basis. Designed around principle of "learning by doing" and structured to provide expertise in key areas of LG need (finance, technical/engineering; social/citizen participation/accountability; fiduciary)	Caisse with assistance of CFAD and DGCPL	Offers opportunity of quick impact and "early wins". Should be fully operational in time for start of 2015.
Targeted Initiatives to Strengthen LG System	• Systematization of LG financial auditing of LGs • Introduction and operationalization of Performance Assessment (PA) System • Introduction of E-Portal to improve access to information to enhance LG accountability to citizens, and to strengthen DGCPL oversight (M&E) • Nationwide workshops to introduce and familiarize LG system with Program and PA system • Targeted training for LGs (procurement, safeguards, other – as needed)	• Cour Des Comptes • CGSP or CGF • DGCPL • CFAD • CFAD	• 2015 • 2016 • 2015 • 2014 • 2015

Independent Verification

61. An Independent Verification Agent (IVA*)* will be appointed. The IVA role is to provide independent confirmation of the results reported by the LG and the CPSCL to the Bank. This includes verification of performance of the Program with regard to the Program disbursement-linked indicators (DLIs), the extent to which the Program DLIs have been achieved, as well as the preparation of a Program Results Verification Report. A consulting firm will carry out such independent verification of results in accordance with the verification protocol.

E. Description and Assessment of Program Expenditure Framework

62. **Review of the current system of financing municipal infrastructure systems:** Infrastructure delivery in municipalities is currently financed by the Central Government through a combination of budget financing, loans from the CPSCL and own source revenues of municipalities. The central budget financing of local service delivery is provided through four channels viz:

(i) Capital investment grants distributed through the CPSCL.
(ii) Recurrent grants provided for meeting current expenditure distributed through the Common Fund for LG (*Fonds Commun*, FCCL).
(iii) Current or investment grants channeled through specific programs (often towards regional councils) to support sector policies defined by sector ministries. Grants are then reflected in the sector ministry's budget.
(iv) Indirect support, often in kind, when central government manages tasks normally under the responsibility of local governments.

63. The capital investment plans of Municipalities are funded out of the Government of Tunisia's Capital Budget (*Titre II*) and appear in the national budget under the budget head for the Ministry of Interior as transfers to the CPSCL (Titre II, line 2.1[2]). Municipal investments take place primarily within the framework of the following three programs or windows: (i) investments supported under the five-year PIC, a form of grant that has some flexibility in the type of investments it supports and in the degree of choice the LGs can exercise; (ii) similar investments supported outside the five-year plan (hors-PIC); and (iii) investments supported under the national program for the rehabilitation of disadvantaged neighborhoods (PNRQP), and currently managed by ARRU. There is a fourth category that provides funds for other types of investments not covered under the other programs, such as regional landfills.

64. The PIC has been operated for over thirty years in Tunisia and follows a central planning model whereby resources are agreed in principle by the MoEF for a five-year investment cycle and are locked in through investment plans prepared for each LG. While the LGs are consulted at the beginning of the cycle on their priorities, final decisions are taken though an inter-ministerial process, managed by the CPSCL, that largely excludes further input by the LGs, with final decisions rarely conforming to LG proposals. At the beginning of each FY the government contribution for the forthcoming year is formally approved in the budget. Municipalities prepare five year investment plans and submit them to the MoEF/MoI for approval. The five year plans comprise a list of capital investment projects that the municipality hopes to implement during the coming five years. Every year municipalities prepare an annual plan comprising a list of projects chosen from the five year plan and submits them for funding from the PIC allocation. A Financing Committee comprising representatives from the Ministries of Finance, Interior, Development and Planning as well as the representative of CPSCL approves the proposals for funding and allocates the capital grants for each of the projects so approved. Table 3 examines the PIC component of the capital budget over the past two PIC cycles, disaggregated into the three main sources of investment funds (own source revenues - OSRs, loans and grants), comparing them to the PIC cycle just commencing (2014-2019). The table also compares allocations with actual expenditures.

65. The PIC establishes a rigid framework that does not permit changes to the plan once it has been confirmed. Consequently, the hors-PIC window has arisen as a means of allowing for some investments to be funded as exceptions to the PIC, and these have to be approved on a case by case basis. The lack of flexibility in the PIC limits the LGs' ability to respond to changing circumstances and priorities, and has particular consequences for the existing status of the LG councils which comprise nominated councilors with little local credibility. Local elections planned for 2015/16 will severely challenge fixed investment plans.

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[2] See link http://www.finances.gov.tn/index.php?option=com_jdownloads&Itemid=712&view=finish&cid=537&catid=1&lang=fr p. 15 of the document

Table 3: Comparison of PIC allocations over three PIC cycles (2002 to 2019)[3]

Funding Source	PIC 2002-2006 TDN Million		PIC 2007-2011 TDN Million		PIC 2014-2019 TDN Million
	Projected	Utilized	Projected	Utilized	Projected
OSRs	170.8	124.2	179.1	121.0	193.0
Loans	302.4	257.5	306.0	260.5	389.0
Grants	209.2	214.6	261.1	267.0	305.0
Total	682.4	596.3	746.2	648.5	887.0

66. The Capital grants under the PIC are part of the financing mix of municipal capital investment plans that include their own source revenues as well as loans issued by the CPSCL. This mix is framed by Decree 97-1135, according to the nature of the investment project to be funded. The usual mix is (for small public works which represent the vast majority of projects) 37% loans, 33% grants and 30% self-financing, but feasibility/engineering studies are funded only through grants, while other types of investments have a different mix. Loans from the CPSCL have an interest rate between 6 and 8.5% and are reimbursable between 7 to 15 years, with the first installment due the second year.

67. Table 4 presents a summary of municipal budgets over the 2002-2012 period. Nation-wide sector specific programs such as the PNRQ, implemented by ARRU, have also required LGs to utilize loan funds as part of their financing plan (see Table 5).

68. **Municipal budgets and levels of investment in municipal infrastructure are modest** for a country with Tunisia's degree of economic activity and stage of urbanization. Over the period of 2002 to 2012 LG budgets have remained small despite the extent to which the country is urbanized. Aggregate municipal budgets are estimated at around Tnd 814 million in 2012, accounting for 1.2% of GDP and 3.6% of national revenues. Municipal revenues have grown at an annual rate of 6.4% over the 2002-2012 period. Adjusted for inflation and population growth, this translates into modest growth in municipal revenues of 1% per capita per year in real terms. Similarly, capital expenditures as well as expenditures for Operations & Maintenance have shown a declining trend while operating expenditures (mainly for meeting staff costs) have shown an increasing trend (see the chart below) .

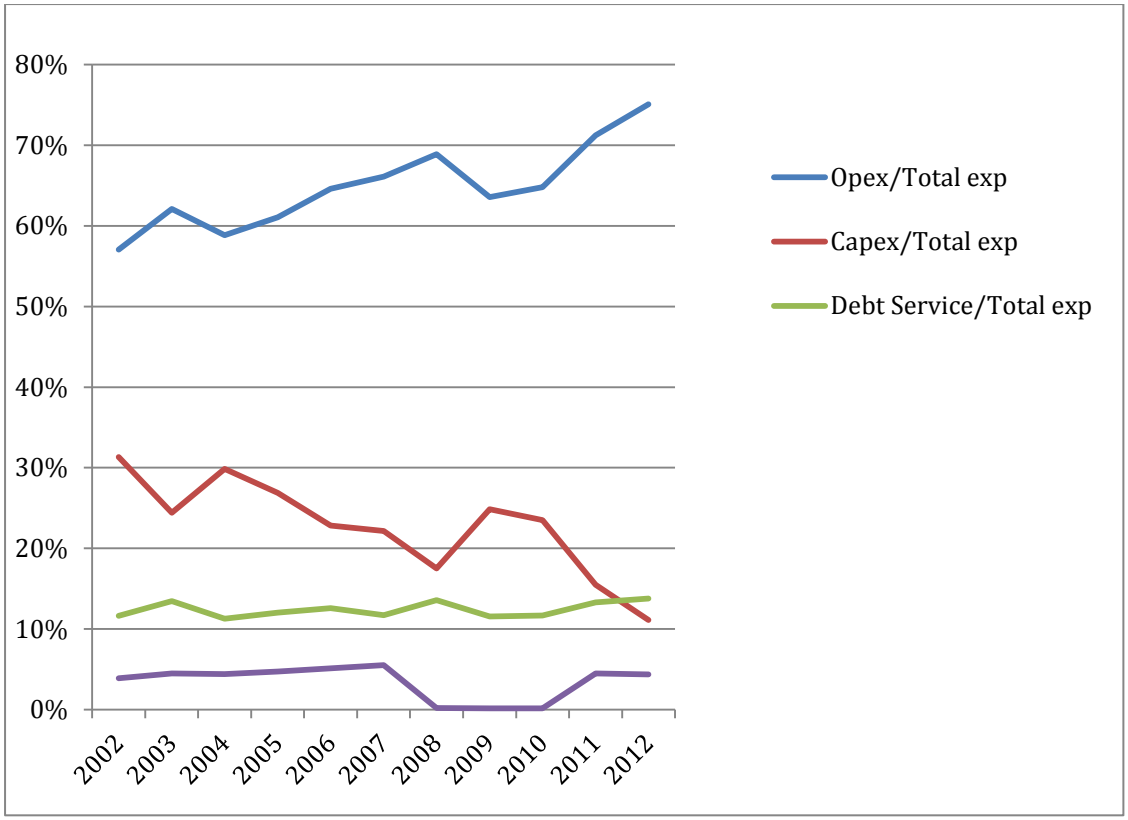
[3] Data provided by the CPSCL; data show a small discrepancy in the Caisse loan amounts between Tables 4 and 5 (about 3%)

Table 4: Aggregate Municipal Budgets 2002-2012

Year	02	03	04	05	06	07	08	09	10	11	12
Recurrent revenues /T1	309	324	351	374	409	427	458	479	536	561	641
OSR	223	234	258	279	312	322	346	360	404	268	370
FCCL	86	90	92	95	98	105	112	119	131	145	176
Exceptional transfers	0	0	0	0	0	0	0	0	0	148	95
Recurrent Expenditure / T1	258	272	289	306	332	350	376	403	428	460	502
Capital resources / T2	160	137	166	166	154	159	170	235	246	218	228
Capital Expenditures / T2	154	130	166	160	149	141	132	188	194	140	129
Investments	129	98	135	126	115	101	89	144	146	87	59
Capital Reimbursement	25	32	31	34	34	40	43	45	48	54	60

Table 5: Capital Grant financing for Municipal investments : 2002-2012

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
PIC	42.1	30.4	85.2	56.1	36.1	31.7	31.2	64.6	109.8	31.8	25.0
Hors-PIC	21.4	9.1	9.1	5.2	6.6	3.7	11.2	13.3	25.3	13.5	7.5
PNRQP	6.2	7.2	20.5	25.4	11.2	12.3	13.7	35.1	39.6	10.3	13.9
Others	0.0	0.0	0.0	0.7	2.0	1.7	0.4	0.5	12.3	2.3	3.5
Total	69.7	46.7	114.8	87.3	56.0	49.4	56.5	113.5	187.0	57.8	49.8



69. Utilization of the loan facility, notwithstanding the maximum grant per investment provision, has remained constant and about 12% less than projected. Similarly OSRs have remained relatively constant and about 30% lower than projected. The proposed capital grant component of the PIC for 2014 to 2019 of Tdn 305 million is equivalent to approximately US$200 million, or about $5.7 per capita per annum, which represents a slight increase in real terms at rates similar to previous cycles after accounting for inflation and population growth. The grants were fully utilized in both PIC periods. When the OSRs and loans are included, the average annual per capita expenditure for the past two PIC cycles, taking into account population growth and inflation, is roughly equal, at about $12, as compared to the projected expenditures for 2014-2019 of $16 per capita per annum, which anticipates significant increases in OSRs and loans, an assumption that does not reflect past expenditure patterns.

70. The Program is introducing a critical shift in the financing and expenditure model for capital grants. Currently the municipalities are forced to adopt a financing mix comprising capital grants (PIC allocations), loans provided by the CPSCL and a pre-specified share of own revenue contribution. As a result municipalities are able to access grant funds only after they have availed themselves of loans which have resulted in many municipalities having taken on debt when they did not require such loans or could not afford them. An adverse consequence of this model has been that municipalities with weak revenue and tax base and often with significant demands for urban services are not able to access grant funds as they are already severely indebted. The Program aims to reform this model by delinking the capital grants from loans and in this regard the Government has already started the process of reform by issuing a Ministerial Decree on the preparation of participatory budgets by LGs, and by agreeing to a major restructuring of Decree 97-1135 that, inter alia, will clearly delink the capital grant allocation from debt financing. Accordingly, allocation and disbursement of capital grants will be made of a simple set of criteria that incentivizes municipal performance rather than their ability to access and sustain loans. In addition, a significant aspect of the reform of the capital

grant system will be the replacement of the existing system of ex-ante review and clearance of project proposals with an ex-poste review of Program implementation and results which will be elaborated in the Program Operations Manual. This is expected to expedite the approval, allocation and disbursement of the capital grants annually. Further, in order to ensure suitable flexibility in the system, and to take cognizance of the re-introduction of LG elections, the prior model of a fixed 5-year PIC will be replaced with a rolling program whereby the 5-year PIC would be adjusted annually to reflect changing ground realities, and/or shifts in priorities. This provision would also obviate the need for the hors-PIC funding system.

71. As part of the annual allocation process for capital grants, municipalities will be required to satisfy the MMCs, upon which they will be allotted their eligible annual capital grant allocations. The annual allocation of the unconditional capital grants (horizontal) will be based on a formula that will be communicated to the municipalities well in advance. The allocation for the conditional Capital Grants will be based on the municipalities satisfying one or more MMCs in addition to the MMCs for the unconditional grants (a process elaborated in the POM). Those municipalities that satisfy the MMCs will receive their eligible grant allocations from CPSCL at the start of the financial year. The CPSCL transfers the necessary funds to the account at the Postal Service (CCP) maintained by the accountant of the local government (*receveur*), who will in turn make payments based on payment invoices issued by the municipality.

72. The expenditure framework assessment has revealed that the MoEF makes adequate budget allocations every year as a matter of course for meeting the financing requirements of the annual plans. However in the current system, municipalities do not receive any advance information on the annual allocations, nor do they know the list of specific projects that will be allotted funding. This makes municipal budgeting a guessing game and results in inefficient and unaccountable allocation of budgetary resources. The Program reforms this model by requiring that MoEF provide information on indicative Capital Grant allocations in advance (by July 15) to municipalities, enabling them to prepare realistic and more strategic annual plans and budgets. At the same time, the previous system of allocation of capital grants based on a project basis and following a series of ex-ante review and control processes, had also resulted in significant delays in project implementation cycles, leading to delays in the utilization of budget allocations and the consequent accumulation of budget resources in the hands of the implementing entities. Recognizing this, the MoEF has relaxed its annual fiscal year rule for transfers to municipalities and as a result municipalities are not required to return unspent budget allocations (relating to capital grants) at the close of the fiscal year. With the reform of the capital grant allocation process, this issue is expected to be resolved with a more efficient financial planning and budget execution system in place. The Program design, in consultation with the relevant Government counterparts, will put in place adequate safeguards (primarily through the performance assessment system) that will prevent the accumulation of unspent balances at the municipal level, thereby mitigating fiduciary risks.

73. Another issue regarding the Program Expenditure Framework relates to the difficulty in obtaining a clear picture of the various fiscal and financial flows to local governments from the existing budget documentation for a variety of reasons. First, the specific booklet for the CPSCL is not public and is held by the government's representative at the Caisse (*administrateur*). Second, a number of financing flows are directly on the budget of line ministries and it is not clear whether they are for operating or investment expenses, and whether there are certain conditions attached to their use. Further, they are not processed through the CPSCL, but directly within the Treasury TSA, and are not consolidated in terms of reporting. To address this issue and to bring about greater transparency in local governance, the DGCPL is designing an "E-Portal" that will be introduced under the Program and operated by DGCPL, and that will provide

comprehensive data on the spatial, demographic, financial, and service delivery aspects of the LGs.

74. The sustainability of the investments being made by the LGs through the capital grants will depend on the ability of the municipalities to improve the mobilization of their own revenues as well as on the ability of both the government and the LGs to restructure the municipal lending program. The LGs face an increasingly serious problem of growing municipal debt, driven largely by the requirement that they borrow from the CPSCL to finance their capital investment program according to the ratios described above. Consequently, although the LGs appear to have relatively stable net operating surpluses at around 9% of recurrent revenues, the extent of the problem is hidden by repeated rescheduling of the debt under the direction of MoEF, and by supplements provided through exceptional transfers to cover increasing recurrent costs, including debt obligations to the CPSCL for infrastructure investment loans (the exceptional transfers are now regularized through the newly created Fond de Cooperacion – FDC). Current LG arrears on CPSCL loans are illustrative. Over 120 LGs are in arrears of 90 days or more, and of these 80 LGs owe amounts in excess of Tdn 250,000. Over 30 LGs are considered chronically indebted and unable to retire their debts. In addition to the financial implications of the debt, the response to dealing with it to date has included: relaxing the loan to grant ratios; introducing new operating grant transfer instruments; and providing exceptional transfers. Furthermore, those LGs capable of raising larger amounts of OSRs and of servicing larger loans have increasingly commanded a larger share of grant allocations on a per capita basis. All of these responses blur the clarity of the grant system and open it up to increasingly ad hoc functional arrangements.

75. Discussions with the MoEF and MoI have revealed that the Government is conscious of the serious debt overhang over municipalities and is desirous of reforming the municipal lending system to make it more sustainable. Currently Agence Francais de Developpment (AFD) is conducting a study to advise the CPSCL on the redesign of their lending policies and appraisal methods, with the objective of transforming CPSCL into a financial intermediary that will operate in accordance with the rules and regulations applicable to financial institutions. Though there is an ongoing program for debt rescheduling for the seriously indebted municipalities, the Program will work with DGCPL and CPSCL to put in place a financial performance recovery plan (FPRP) to enable municipalities to undertake prudent debt management strategies and will provide necessary incentives for their speedy implementation. The effective implementation of the FPRPs will be incorporated into the performance assessment system. The Program will also incentivize municipalities to improve own source revenue mobilization by including this as a key performance area under the performance measurement system. In addition, efforts are underway to carry out a PEFA assessment of local governments that is expected to enhance the Public Financial Management framework of municipalities.

76. The proposed Program will be included in the annual budget of the Government under the budget allocation head for MoI. Indicative allocations for capital grants will be included in the Five Year Plans and will be communicated to the municipalities in advance of the preparation of the annual plans and budgets. The annual capital grant allocations will be included in the government's annual Investment Budget and will appear in the MoI's budget as transfers to the CPSCL (Titre II, line 2.1[4]). There will be specific budget lines that will provide

[4] See link

http://www.finances.gov.tn/index.php?option=com_jdownloads&Itemid=712&view=finish&cid=537&catid=1&lang=fr p. 15 of the document

for each of the elements of the Program. The budget lines will also specify the rules for the utilization of the Program funds. As part of the reform to the existing system of capital grant allocations, the MoEF will issue a separate arrête (Government order) that will define the access conditions, as well as operating rules for the capital grants. The budget allocations for Program elements will be transferred in a single tranche annually, no later than February 1, from the Treasury Current Account at the Central Bank (BCT) to CPSCL, which will act as the Program Manager for the capital grant program. CPSCL will in turn transfer the full amount of the grant funds to the LGs' accounts held in the Treasury on their behalf, as well as to other Program implementing entities in accordance with the Program operating rules as detailed in the POM.

F. Description and Assessment of Program Results Framework and M&E

77. The Program will be monitored and evaluated through the use of a number of M&E tools throughout implementation, including regular reports from the LGs to the CPSCL,, the LGs' annual statements of conformity with the MMCs, the Annual Performance Assessments (PAs) as undertaken by the CGSP, and the Midterm Review (all the procedures and formats for undertaking the assessments and/or reporting will be detailed in the POM and its annexes, incuding the manual for the PA system).

78. Under current systems, the CPSCL has maintained up-to-date, real time monitoring of physical works in all LGs. Under the Program, an E-Portal is being established to monitor LG operations across a number of parameters, and the CPSCL will now feed this data into the E-Portal once it has become operational (end of year 1 of the Program). To-date, reliable basic financial information on revenues and expenditures of LGs has been uneven. Under the Program, the MMCs proscribe timely preparation of final accounts for all LGs, and the CPSCL will also upload this revenue and expenditure information from the final accounts into the E-Portal from the end of the first year.

79. The primary source of essential information, and the major M&E tools to verify the performance of the LGs are the annual MMCs and the results of the PAs (which will also be entered into the E-Portal). The PA will be carried out in line with the PA Manual, which will be finalized and adopted by the end of 2015, with its content and quality acceptable to the Bank. The manual will provide clear definitions for each indicator, as well as comprehensive guidance on the scoring. Adjustments, which might need to be made to the performance indicators and scoring, will be done during a dry run of the system in 2016. Future adjustments will be made as needed in the light of experience. and all these sources will be captured by the CPSCL in preparing its annual Program progress report. The data from the assessments will be uploaded onto the E-Portal, together with the revenue and expenditure and physical works progress, and will be used both for preparing annual consolidated reports by the CPSCL, as well as for tracking progress against projected results.

80. Progress towards the PDO will be measured through a set of simple and measurable indicators, utilizing the data on the E-Portal; most of them will be linked to disbursements. The Results Framework for the Program has three key results areas that are closely inter-related. Each results area is reflected in one or more associated Disbursement-Linked Indicators (DLIs), Program Actions and planned capacity support, as well as to monitoring, evaluation, and verification activities in the Program. This provides a coordinated incentive for LGs to improve their institutional capacity to perform their essential functions. The Results Framework is

provided in Annex 3, and the DLIs are summarized in Table 6 below. The results and the DLIs, and their associated results chains, are described as follows:

81. **Result Area 1: Capital Grant System Reformed:** The targeted outcomes of the Program in this Intermediate Results area are: (a) Decree 97-1135 is amended; (b) the LGs are given timely confirmation of their capital grant allocation for the forthcoming year, so that they can utilize it effectively in finalizing their municipal investment plans and their capital budgets, and the funds are transferred in a timely manner to their accounts for application to the funding of their budgeted investments; and (c) the eligible LGs meet the required MMCs in order to qualify for disbursement of their grant entitlement. The targeted outcomes in this result area are addressed by DLIs 1, 2 and 3. DLI 1 stipulates that the Reformed Capital Grant system is fully operational. DLI 2 stipulates dates for final confirmation of each LG's annual grant allocation (December 1) and for the release of funds to the LGs (February 1). The adoption of the Decree is pivotal as it comprises a series of clauses that regulate all the elements of reform that the Program seeks to support (the adoption of an objective allocation formula; the timely release of the annual allocations; the provision that determination of the use of grant funds is solely at the discretion fo the LG; that the LG should demonstrate effective participatory investment planning; the delinking of the grants from the loans; the phased introduction of the performance assessment system; and the requirement that the assessment be undertaken by an independent agency and that its findings be made public in a timely manner). DLI 3 addresses the other outcome of this Intermediate Result by stipulating annual targets for the minimum number of LGs satisfying the MMCs.

82. **Results Area 2: LG institutional performance improved to deliver municipal infrastructure and services:** The targeted outcomes in this results area are: (a) the LG performance assessment system established and fully operational; (b) that the LGs are implementing their Annual Investment Plans on schedule; (c) that capacity support to the LGs is provided according to their annual capacity support plans; and (d) that information on the grant transfer that each LG receives and on the results of the LG's Performance Assessment are publicly accessible. The DLIs address these outcomes as follows: DLI 4 sets out annual benchmarks to be achieved for phasing in and making operational the performance assessment system ; DLI 5 stipulates the percentage of LGs achieving annually rising minimum levels of expenditures on capital works specified in the LGs' investment plans; DLI 6 takes account of the number of LGs that have implemented their annual capacity development plans; and DLI 8 addresses the outcomes sought as follows: by the second year it requires that the E-portal be up and running, and being populated with relevant data; and for years three through five it scales up the number of LGs for which financial audits have been completed to 80% by 2018.

83. **Results Area 3: Improved access to basic municipal infrastructure in disadvantaged neighborhoods:** The expected outcome under this results area is improved access to basic municipal infrastructure in disadvantaged neighborhoods within the 114 targeted municipalities. DLI 7 requires that the Investment Plans by the targeted LGs for investment in the selected disadvantaged neighborhoods are executed according to schedule, and provides annual targets to be met measured in percentage works started and percentage works completed, with 100% of construction in all targeted neighborhoods completed by the final year.

G. Disbursement Linked Indicators

84. The DLIs, elaborated above, have been selected to reflect critical elements of performance required to achieve the PDOs as well as the intermediate outcomes, as reflected in the results areas above.

Table 2: Disbursement Linked Indicators

Disbursement Linked Indicator	Estimated disbursement amounts (US$ million)
DLI 1: The Borrower has replaced Decree No 97-1135 and restructured its capital grant system accordingly.	30
DLI 2: Timely communication to LGs of the indicative Capital Block Grants (CBGs) allocation and timely transfer of CBGs to eligible LGs by the Borrower.	20
DLI 3: Acceptable percentage of LGs have met the MMCs and received CBGs.	30
DLI 4: The Borrower has designed and implemented an independent LG performance assessment (PA) system and required percentage of LGs have met the threshold PA scores.	90
DLI 5: Required percentage of LGs have executed their Annual Investment Plans on schedule in terms of expenditures.	45
DLI 6: Required percentage of LGs have received capacity-building support in accordance with their annual capacity development plan.	25
DLI 7: Targeted number of people living in targeted disadvantaged neighborhoods have benefited from improved municipal infrastructure.	40
DLI 8: Transparency and access to information have been improved.	20
Total	**300**

85. The Program Results Framework and DLIs represent a consistent results chain across all levels of government and create a complementary set of incentives necessary to achieve the PDO. At the Program level, each set of DLIs provides an essential complement to the others. For example, institutional strengthening is a critical requirement for both infrastructure delivery and sustainability, and must be supported by an enabling policy environment. The selection of specific DLIs reflects the assessment of critical challenges facing local governments and national government that are considered to be essential to the achievement of Program results. Moreover, dedicated local management capacity is essential to effective local planning and sub-project execution, while national oversight is essential to strengthening local accountability as measured through the annual evaluation and assessment process.

86. The disbursement amounts associated with the DLIs are weighted to reflect these mutually reinforcing relationships between better use of public money, improved local institutional performance and accountability, increased municipal infrastructure investment, effective asset management, and access to fiscal transfer and LG performance information.

87. The elaboration of the DLIs, the DLI verification protocols and the basis for the calculation of disbursements are provided in Annex 4.

H. Program Economic Evaluation

88. The following economic analysis contains several elements. It provides an analysis of the development impact of the Program through economic return, alternative project, risk, and fiscal sustainability analyses of this project. It outlines measures to facilitate continued economic analysis of the project, provides a rationale for public sector provision and financing, and explains World Bank value-added.

Development Impact

89. The expected development impacts of the Program are improvements in: the infrastructure and services provided by local Governments (LGs) in Tunisia for all of their residents; LG capability to deliver infrastructure and services; and the relationship between Tunisians and their Government. Despite gains in access to infrastructure and basic services in Tunisia over the past two decades, large disparities remain in access to basic services administered by LGs (namely public sanitation networks and local roads). Approximately 25 percent of Tunisians are disconnected from a public sanitation network with substantial differences in access within and across LGs.[5] Poor sanitation network connections can lead to higher incidences of illnesses such as diarrhea compromising the health of relevant populations and their financial resources due to the costs associated with these illnesses. In 2004, a study estimated that the annual costs associated with diarrheal incidence in Tunisia were between 11 and 56 million TND.[6] Citizen discontent with services under the mandate of LGs was indicated in a recent survey conducted by the Bank on Tunisian citizen perceptions of Government provision of services. Poor local road networks are associated with constrained access to markets. The January 2011 Revolution highlighted the grievances of marginalized populations in Tunisia and the large-scale impact neglecting those grievances can have on development and prosperity across the country; as such, the dual goals of helping marginalized Tunisians attain a minimum standard of quality of life and improving the relationship between citizens and Government are urgent priorities for the Government. More detailed economic analyses of the project are provided below.

Economic Rate of Return

90. The measurement of economic rates of return (ERRs) for LG strengthening programs is not straightforward for several reasons. Reform of the inter-governmental capital grant system is designed to empower LGs and their citizens, hence the specific investment projects that will be financed through the grant(s) supported through this Program are unknown at this stage. Furthermore, the projects that can be undertaken by LGs with the support of this Program – particularly local roads, drainage network connections, and street lighting – are small-scale with many of the benefits non-rigorously quantifiable. The Government has not mandated economic analyses for these types of projects in the past, hence no data exists that could be used to quantify the benefits of similar projects in Tunisia. Rate of return analysis is even more difficult to do in a rigorous and credible manner for institutional development strengthening activities.

[5] For instance, only 7% of homes in Tunis have no connection to the public sewerage system while 88% of homes in Sidi Bouzid do not have access to public sanitation service (WB 2013).

91. Nevertheless, there is evidence of positive returns for some similar Local Government support projects that have been supported by the World Bank in other countries. In Uganda, an assessment of the first Local Government Development Program (LGDP1) found that the ERR of the small infrastructure projects provided through LGs was above 12 percent.[7] A similar project in the Philippines – the Local Government Finance and Development Project – yielded an ERR of 35 percent.[8] Although the context and the exact bundle of investment projects vary, these findings indicate that if well-designed and implemented, this Program could generate positive economic returns. It is proposed that feasibility studies for any investments estimated to cost more than US$1.0 million undertaken by the LGs under the Program will require ERRs to be included and this will be captured as part of the annual PAs. It is also proposed that a program for undertaking social and economic impact analyses of selected LGs, designed to provide indicative data on qualitative outcomes, would be undertaken during the course of Program implementation.

Productive Efficiency

92. The proposed reform of the inter-governmental capital grant transfer system and the institutional development strengthening activities are expected to increase the productive efficiency of LGs. Productive efficiency has been achieved in settings where citizens were better able to hold LGs to account, where fewer tiers of Government were involved in service delivery and the tier providing the services had better knowledge of local costs.[9] World Bank studies have found that in many cases, infrastructure delivered in decentralized contexts was of higher quality and was completed at lower cost than in more centralized settings, and that results-based approaches to municipal development achieved more sustained impacts.[10] For instance, the cost effectiveness of local roads produced in the Uganda LGDP-I project was in the range of 32.6 - 38.9 percent of the total investment.[11] Furthermore, the greater scope for decision-making, technical support to enhance learning by doing, and accountability loops introduced through this project are expected to help increase the organizational performance of LGs.

Allocative efficiency

93. Greater discretion[12] over the use of their resources is expected to improve the allocative efficiency of LG infrastructure and service provision. International experience demonstrates that LGs are capable of better allocating resources according to citizen preferences than central Governments when they have adequate discretion over the use of resources and when citizens can monitor local Government performance.[13]

Alternative Project Considerations

94. Several alternatives could have been pursued in place of the proposed Program. One option would have been for the Government to continue with business as usual. Under this scenario, the deterioration of the provision of LG services and infrastructure, and the financial health of LGs was likely to continue. Alternatively, the Government could have pursued an emergency project to provide basic infrastructure and services through central authorities rather than through LGs. This measure could have been justified on the grounds of the urgent need to address these basic needs of citizens and alleviate social tensions associated with the

[7] World Bank ICR 2008
[8] World Bank ICR 2009
[9] Kahkonen and Lanyi 2001
[10] Martinez-Vasquez 2011, IEG 2008, and UNCDF 2008.
[11] World Bank ICR 2008
[12] Combined with greater citizen participation and enhanced accountability mechanisms.
[13] For example, local budgets better matched citizen priorities after further decentralization in Uganda & the Philippines (Martinez-Vasquez 2011).

2011 Revolution. However, it would have further undermined LG authority. It also would have foregone a critical opportunity to foster accountability mechanisms between citizens and the Government. Other program design parameters could have been altered, and several such considerations were made during Program preparation, but the proposed design reflects a consensus regarding the design that promoted the greatest development impact given existing constraints.

Rationale for Public Sector Provision and Financing

95. There is a strong rationale for public financing of the activities supported under the Program. Specifically, the rationale for public sector provision and financing is that: (i) the investments are local public goods; and (ii) no negative substitution effects are anticipated.

96. *Most of the Program investments are in public goods.* The municipal investments eligible for support under the unconditional and conditional grants are mostly local public goods, and therefore likely to be undersupplied by the market. These include municipal roads, street lighting, drainage, water supply and sanitation, solid waste management, and local social and economic infrastructure. The provision of these goods is under the responsibility of LGs as per the 2014 Constitution, in keeping with commitment to achieve a more efficient and closer administration to citizens.

97. *No negative substitution effects.* The Program focuses on improving the efficiency of transfers for infrastructure investment and capacity of LGs to select and implement projects. It is therefore not expected to lead to any substitution effects on infrastructure investment. The projects will continue to be selected through guidelines for preparation and evaluation of subprojects outlined in the Program operations manual, [14] although LGs will be given full responsibility and autonomy for the selection, preparation and execution of local investments supported by the grants. The allocation and implementation of funds is therefore expected to improve with the project, and is not expected to have any new negative substitution effects.

World Bank Value-Added

98. The World Bank adds value to the Program through financing, relevant and operational *expertise*, and by its ability to help leverage additional resources.

99. The institution has extensive experience supporting inter-governmental fiscal transfer system reforms, programs to strengthen LG capabilities, and programs to increase access to municipal services and infrastructure in Tunisia and around the world. The World Bank has supported consecutive municipal development programs in Tunisia since 1992. More broadly, the World Bank has supported decentralization efforts in more than 89 countries in the world since the 1990s, including in Morocco, Jordan and West Bank and Gaza in the Middle East.[15] An IEG assessment of a subset of World Bank decentralization operations found that the impact of many of these operations was weak in the 1990s but improved considerably in the 2000s.[16] This improvement may be attributable in part to World Bank staff disseminating lessons learned as appropriate to other projects over time. These lessons range from the importance of pairing certain reforms to the necessity of having effective performance monitoring systems in place and in use. Such lessons have been reviewed and have informed the World Bank's engagement with Tunisia on this Program.

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[15] IEG 2007
[16] IEG 2008

100. Furthermore, the World Bank can help relevant parties in the Government leverage support for its LG development program as it undertakes this set of reforms in a politically challenging environment. Reform of the distribution of national wealth, and of formal linkages and practices that change the relationship between different levels of Government and between Government and society are by definition challenging to accomplish. The current socio-political context provides both an impetus and a constraint to the successful introduction and implementation of such reforms. The involvement of a relatively neutral actor – the World Bank – in helping facilitate the national dialogue and deliberations needed to define and introduce these reforms can help accelerate and improve the outcomes of these efforts. Furthermore, the Bank's commitment to this reform program has helped attract additional development partners to support selected aspects of the reform program.

I. Technical risk rating

101. Although the CPSCL, in charge of day-to-day management of the Program, has significant experience implementing similar municipal investment programs with World Bank support, and has operated in concert with all the LGs to be supported under the Program, the overall risk rating is high due to country circumstances, the fiduciary implications of shifting from an ex ante to an ex post system of oversight; and the emphasis on improved performance by the 264 LG stakeholders for undertaking functions that currently represent their weakest areas of capability. The shift from a tutelle system to one of decentralized authority and accountability is transformational, and in a country in political transition represents a high level of risk.

Annex 1: Detailed Program Description

I. The Government Program

1. Recognizing that decentralization is a longer term process, the Government has proposed a phased approach to LG reform, taking into account the importance of showing results on the ground now. The Government is therefore introducing a near-term program comprising key elements that: (i) can be immediately and practically introduced; (ii) lay the groundwork and have the maximum impact possible for introducing key reforms embedded in the decentralization objectives of the Constitution; (iii) focus on strengthening the capability of LGs to be better able to deliver local municipal services, and to do so in a manner that is fully accountable to their citizens; (iv) address disparities between LGs and regions in local service levels; and (v) at a minimum sustain planned levels of investment in local municipal services while creating the platform for future scaling up.

2. Specifically, the Government has recognized that the restructuring of the capital grant system for transferring investment resources to LGs, governed by Decree 97-1135, can be undertaken early on and offers significant opportunities to establish greater accountability between LGs and their citizens, as well as concurrently building the institutional capacity of the LGs to better deliver local services. The revision of the Decree is pivotal to effective operation of the LG capital grant system, and lies at the heart of the reforms necessary to address the issues identified above and respond to the decentralization mandate of the constitution. The changes to the decree that are necessary to underpin the first phase of the Government's decentralization reforms include:

- Separating the access of LGs to capital grants from the requirement to borrow and to mobilize own source revenues, thus removing one of the key drivers of growing municipal fiscal stress, as well as leveling the playing field so that the fiscally stronger LGs don't gain disproportionate shares of the grant;
- Ensuring transparency in the capital grant allocation system and enhancing accountability between LGs and their citizens by introducing formula-based annual transfers that are constructed around objective, measurable criteria, and that ensure predictability of fund flows in order to enhance efficient planning by the LGs;
- Providing timely indicative annual allocations to the LGs to facilitate their ability to undertake participative municipal investment planning and efficient use of resources;
- Progressively introducing an independent, annual performance assessment system to strengthen LGs' institutional capacities for better service delivery and to facilitate greater citizen access to information;
- Publishing the findings of the performance assessment in a timely manner; and
- Removing ex ante central controls over capital grant planning and utilization, thus enabling use of capital grants to be determined at the discretion of LGs.

3. In this context, the Government program consists of delivering municipal infrastructure services in an accountable and responsive manner through a mix of grants, own source revenues and loans, as well as institutional strengthening of the 264 municipalities for the period 2014-2019. Through this program, the Government intends to shift from a purely "infrastructure delivery" approach to a greater focus on LG performance and accountability**.** To this end, the Government's program aims at: (i) strengthening LG institutional capabilities; (ii) transforming their relationship with their citizens through measures that are designed to foster transparency, participation and accountability; and (iii) improving the municipal infrastructure delivery with special attention to disadvantaged communities.

4. The Government program consists of three sub-programs, namely:

- Subprogram 1: Municipal infrastructure delivery;
- Subprogram 2: Improving access to municipal infrastructure in disadvantaged neighborhoods;
- Subprogram 3: Capacity support for improved LG institutional development and accountability.

Subprogram 1: Municipal infrastructure delivery (US$591 million)

5. Consistent with past practice under the PIC, the subprogram involves the preparation of five-year investment plans for each LG to deliver municipal infrastructure. Activities under the subprogram will include consultancy services (including feasibility and engineering studies, and implementation support), and civil works directly linked to LGs core mandates such as roads and paving, construction, rehabilitation and upgrading, street lighting, sewerage extension/connection to public network, storm water drainage, solid waste collection, parks and some recreation facilities, markets, and other environmental improvements.

6. The financing framework for the activities under this subprogram includes three sources of finance: (i) LG contribution; (ii) capital grants from central Government; and (iii) investment loans provided by the CPSCL. These sources of finance are discussed in the following paragraphs.

7. **Capital Block Grants for Municipal Infrastructure Delivery (US$203 million).** The capital block grants will be allocated on the basis of a formula, with their use determined solely at the discretion of each LG (without any ex ante controls) and validated through a participatory planning approach that contributes to determining investment priorities. Final investment decisions on the use of the grant funds will be reflected in the LG's five-year (PIC) and annual investment plans, and are limited to municipal infrastructure works and equipment that fall within the functional mandates of the LGs. The funds will be distributed to the LGs by the CPSCL, which will administer the grants on behalf of the state. The LGs will be responsible for planning and implementing sub-projects financed by the unconditional capital grants, and the grant funds will be reflected in the revenues and expenditures of the LG annual budgets, with the corresponding assets being incorporated into their asset registers. Sub-project implementation will be undertaken by LGs with the support, if needed, of deconcentrated public agencies and/or private entities.

8. The unconditional capital grant will be accessed by all 264 LGs in Tunisia, as well as any new municipalities that may be constituted during implementation of the program. The funding will be spread over five years, ending in 2019, with the annual distribution of the 2014-2019 five-year budget envelope phased according to an assessment of the likely expenditure profile based on experience of prior PIC expenditure patterns. Based on these principles, Table 1.1 provides an example of a distribution profile over the five-year plan period that could be used to determine annual allocations of the grant funds to the LGs.

Table 1.1: Example of an Annual Distribution of the Unconditional Grant over the Five-Year Program Cycle (US$221)

2015		2016		2017		2018		2019	
%	US$	%	US$	%	US$	%	US$	%	US$
10	22.1	15	33.15	25	55.25	25	55.25	25	55.25

9. Using a distribution schedule along the lines of the principles suggested in the table, and applying to it, for each LG, the allocation formula that is being established under the new Decree (see para 31 below), will then determine the indicative annual amount of the grant that each LG will be entitled to receive over the five-year period, subject to it satisfying the performance requirements every year. The allocation formula is to be calculated using the following criteria: 80% is determined by population based on data provided by the National Institute of Statistics; 20% is determined by the fiscal capacity of each LG according to its maximum potential for revenue generation from local taxes and fees, based on data and analysis provided by MoEF.

10. The unconditional capital grants will operate according to the following principles:

a) a PIC whereby each LG is allocated an indicative envelope of resources available to it for capital investments over a five year period, to be transferred annually at the beginning of each CY;
b) the allocation formula is to be made public, as are the annual allocations to each LG;
c) the allocation formula is built around objective, measurable criteria that also include equalization considerations;
d) use of the funds is discretionary to the receiving LG and is not subject to ex ante review by central agencies;
e) access to the funds, which can be integrated with other untied LG revenues at the local level, is not tied to other parallel fiscal or financial instruments;
f) LG performance is assessed annually, ex post, by an independent evaluator, whose findings are made public and are presented comparatively across all LGs; and
g) application of performance standards to determine eligibility to receive the grant funds, and that comprise two parts: minimum mandatory criteria (MMCs) based on selected existing legislation and/or regulation (see para 32); and an annual, independent performance assessment that takes into account broader considerations including key aspects of the following three areas: governance, sustainability and management (see para 38).

11. The total unconditional capital grants for municipal infrastructure amount to US$5.7 per capita/year. Key investment activities of the program include road construction, rehabilitation and upgrading, street lighting, urban drainage/sewerage and other environmental improvements, solid waste collection and street cleaning, parks and some recreation facilities, markets and slaughterhouses.

12. **Local Government Contribution (US$129 million).** In parallel with the above capital grants, the Government's 2014-2019 PIC envisages significant increases in the level of LG contributions to investment in municipal infrastructure. The Government recognizes that reforming the own source revenue system will take time as it involves major policy changes, and is therefore focusing on opportunities for improving local revenue collection rates within existing tax and fee regimes.

13. **Municipal Investment Loans (US$259 million):** In addition, LGs capable of borrowing will have access to the CPSCL credit line as a potential funding source to implement their municipal investment plans. The loans from the CPSCL serve to maximize leverage of resources available to LGs for investing in municipal infrastructure. In parallel, the Government is introducing reforms under the Decree and in the CPSCL lending guidelines in order to establish a stable balance between maximizing borrowings by the LGs and maintaining their financial viability, as well s the stability of the CPSCL.

Subprogram 2: Access to municipal infrastructure in disadvantaged neighborhoods (US$150 million)

14. Under this subprogram, the Government will provide targeted/conditional grants directed towards investments that represent national policy priorities (in this case, for the new PIC period, to improve access to municipal services in disadvantaged neighborhoods).

15. Due to resource constraints and the uneven distribution of disadvantaged neighborhoods across LGs in the country, a regional consultation process (involving elected officials from the National Constituent Assembly, representatives from regional and local Governments, civil society, and deconcentrated agencies) was undertaken to pre-identify neighborhoods and municipalities that would qualify to receive these grant funds during the CY2014-2019 cycle. Municipalities currently covered by ongoing urban upgrading programs are not targeted by the Program. As a result of these consultations, 144 LGs have been identified.

16. Activities under the subprogram will include consultancy services (including feasibility and engineering studies, and support to implementation services) and civil works for the provision of basic infrastructure such as roads and paving, street lighting, sewerage extension/connection to the public network, and storm water drainage in 229 selected, disadvantaged neighborhoods located in the 144 LGs.

17. Since 1992 Tunisia has been implementing national programs targeting the upgrading of disadvantaged neighborhoods with the provision of basic municipal infrastructure (PNRQP). However, most of the urban upgrading sub-projects were identified and prioritized by the center and implemented by the *Agence de Rehabilitation et de Renovation Urbaine* (ARRU), a dedicated national agency. LGs were merely consulted but had to co-finance up to 30 percent of the total cost.

18. The new approach will introduce major changes to past practices, including: (i) full ownership by, and responsibility of, LGs for preparing and implementing the investments in disadvantaged neighborhoods as part of their municipal investment programs; (ii) substantive consultative and participatory approaches for neighborhood identification/prioritization and for determining neighborhood priority investment needs; (iii) highly subsidized financing aligned with the financial capacity of LGs in order to avoid further exacerbating municipal finance stress in accessing capital grants; and (iv) provision of just in time support to LG to implement sub-projects and develop greater capacity from the implementation experience.

19. The conditional grant allocation over the program period amounts to US$ 142 million or an average of about US$ 1 million per LG which represents around US$284/beneficiary (US$1420/household).

Subprogram 3: Capacity support for improved LG institutional development and accountability (US$10 million)

20. The Government's program upgrades the system of capacity support for LGs in order for them to achieve improved institutional performance targets. The capacity support program would contribute to the LGs ability to achieve the standards required under the performance assessment system to help them access their full entitlement to capital grants. Under this subprogram, LGs receive capacity development and technical support to prepare and implement their plans via training programs offered by CFAD and technical assistance from regional offices of the CPSCL and line agencies of central Government, as well as through local consultancy services.

21. An allocation of US$10 million will be committed through the national budget for the financing of this subprogram. Half of this amount is earmarked for technical assistance through framework contracts to be signed at the level of each regional office of the CPSCL for the provision of on

demand technical assistance to LGs. This program being demand-based, the Government envisages the commitment of additional resources if assessed necessary during the Program's Mid-Term Review.

22. The Government program is summarized below in Table 1.2, with the outlined area of activities targeted for inclusion under the PforR Program.

23. **Table 1.2: Government's program and PforR Program scope**

<table>
<tr><td>Subprogram 1
Municipal infrastructure delivery
TND 887 million (USD 591 million)</td><td>Subprogram 2
Improving access to municipal infrastructure in disadvantaged neighborhoods
TND 225 million (US$ 150 million)</td><td>Subprogram 3
Capacity support for improved LG institutional development and accountability
TND 15 million (US$ 10 million)</td></tr>
<tr><td>Unconditional Capital Grants TND 305 million (US$ 203 million)
Formula-based grant allocation to LGs subject to their meeting annual Minimum Mandatory Conditions (MMCs) and achieving satisfactory annual performance scores</td><td rowspan="3">Conditional Capital Grants TND 225 million (US$150 million)
Grant allocation to LGs for specified investments in line with national priorities (currently for local infrastructure in disadvantaged neighborhoods), subject to their meeting a Minimum Mandatory Condition (MMC) grant access requirement</td><td rowspan="3">Capacity building and technical support TND 15 million (US$ 10 million)
Demand-based capacity support to be provided to LGs on a just-in-time basis</td></tr>
<tr><td>LGs Contribution
TND 193 million (estimate)
LGs Contribution to the investments from their net savings</td></tr>
<tr><td>Municipal investment loans
TND 389 million (estimate)
Investment loans to LGs from CPSCL</td></tr>
</table>

II Program PforR: the Program

24. **Development Objective:** The objectives of the Program are: (i) to strengthen Local Governments' performance to deliver municipal infrastructure, and (ii) to improve access to services in targeted disadvantaged neighborhoods.

25. The Program will support most of the Government program activities with focus on capital grants for municipal infrastructure delivery and the institutional and capacity building elements:

26. **Duration:** Program implementation period is from 2014 to 2019.

27. **Geographic scope.** The Program will finance activities in the same geographical areas (the Program Area) covered by the Government: all 264 municipalities (LGs), plus any new ones that may be constituted during Program implementation.

28. **Sub-programs to be supported.** Based on the need identified during the preparation of the Government program and for increased selectivity of Bank support, the Program encompasses three primary activities: (a) capital block grants for municipal infrastructure delivery; (b) targeted capital grant for improving access to municipal infrastructure in disadvantaged neighborhoods; and (c) capacity support for improved LG institutional development.

A Capital Block Grants for Municipal Infrastructure

29. The capital block grants would be performance-based to incentivize LGs to achieve improved standards of institutional performance in key areas of their municipal functions. The target would be for 60 percent of LGs to achieve threshold scores (levels to be determined during preparation of the performance assessment manual) or more on their performance evaluation for the fifth year of the Program. To achieve the targeted outcomes, the Program provides resources under the unconditional grant sub-window for investments in local infrastructure services, with funding levels modulated by each LG's ability to meet annual performance standards applicable to unconditional grants as measured by annual Minimum Mandatory Conditions (MMCs) and Performance Assessments (PAs) undertaken according to agreed criteria.

30. Under the Program, all 264 LGs will receive capital block grants from the Government to support priority investments in urban infrastructure that have been identified and reflected in their participatory five year and annual LG investment plans. The LGs will be responsible for planning and implementing sub-projects financed with capital block grant funds, and grant funds will be reflected in the revenues and expenditures of their annual budgets.

31. Capital block grants will be allocated to the LGs according to a transparent and predictable formula. These allocations are weighted by LG population and fiscal potential (80/20), subject to the application of an adjustment factor to ensure that each municipality will receive at least the equivalent of the envelope received during the previous PIC. These allocations provide an average annual allocation of US$5.7 per capita over the period of the Program, representing roughly a similar level of investment compared to the current PIC (adjusted for population growth and inflation).

32. These allocations are for planning purposes and the actual annual disbursement of funds will be made on the basis of verification of: (i) annually meeting the Minimum Mandatory Conditions (MMCs); and (ii) each LG's performance as measured against a set of criteria. Specifically, the performance system consists of two levels of review, one comprising the MMCs, which will be applied to determining each LG's access to grant funds in 2015 and every year thereafter under the Program, the other an annual Performance Assessment (PA) process which will be applied to determining the level of individual LG access to grant funds in 2017 for budget year 2018, and every year thereafter.

Minimum Mandatory Conditions (MMCs)

33. The performance criteria to be met to satisfy the MMCs are derived from essential, minimum legal and regulatory provisions and also include core fiduciary requirements to assure satisfactory ex post oversight, as well as establish the basis for some of the performance standards to be included in the Performance Assessments (PAs). To this end the criteria comprising the MMCs include the following:

- The municipal budget for the forthcoming year has been adopted by the Municipal Council by December 31;
- The annual financial statement of the LG for the previous year has been submitted to the *Cour des Comptes* for audit no later than May 31 of the current year;
- The annual municipal investment plan for the forthcoming year was produced according to satisfactory participatory procedures;
- The LG's Procurement Plan for the forthcoming year has been uploaded onto the National Procurement website by December 31; and
- The Municipal Council has approved and the mayor has signed a Memorandum of Understanding with the Government through the CPSCL that will spell out the roles and responsibilities for both.

34. A LG that is unable to satisfy all the MMCs is held to be ineligible to receive any grant resources for the forthcoming year. However, the funds remain assigned to the LG's account and are reapportioned to it over the remaining years of the Program. In the event the LG fails to qualify for two years running, the funds due it in the forthcoming year are returned to the pool of funds to be used for allocation to all the LGs.

Annual Performance Assessment

35. An annual and independent Performance Assessment (PA) will be progressively introduced with effective implementation for the 264 LGs during the third year of the Program. During the first two years, the Program will support the detailed design of the PA Manual, the preparation and organization of information and awareness events targeting LGs and supporting agencies; and the implementation in 2016 of a dry run. The operation of the performance system will be refined and adjusted as necessary during the preparation of the PA manual and to take account of the experience gained through the dry run, but will remain consistent with the principles described above. Once fully operational (in 2017 to influence disbursements to LGs in 2018), the PAs will be implemented annually, and will be managed by an independent agency – the General Controller of Public Services (*Contrôleur Général des Services Publics,* cGSP).

36. Once the PAs have been phased in in 2017 (for application to the 2018 grant allocation), both elements of the performance system (the MMCs and the PAs) will be applied. Thus, from year 2018 onwards, each LG, on satisfying the MMCs, will receive a disbursement of 40 percent of the funds available to them as determined by the allocation formula. Those LGs obtaining a threshold score (the threshold level is to be determined during preparationof the performance assessment manual) on their PAs will receive the remaining 60 percent of their allocation. For LGs unable to achieve the requisite score, the remaining share of their allocation for that year will be combined with the remaining funds they have been indicatively allocated under the five-year envelope and will be apportioned as per Table 1.3 for allocation in subsequent years. In the event a LG fails to meet the 70 percent score in two successive years, the funds for the forthcoming year will be reallocated for the remainder of the PIC period amongst all the LGs.

37. The PA exercise will start on May 1 of each year and be completed (including all reports required to present findings and recommendations) by August 31. The findings of the PA would then be applied in time for the disbursements of grant funds in CY 2018 and all subsequent fiscal years. The differential phasing in of the MMCs and the PAs over four years, and the different weightings assigned between the MMCs and the PAs will have significant impacts in determining annual disbursement levels. Table 1.3 demonstrates the proportionate share of the annual disbursement that is determined by satisfying the MMC requirements and the proportionate share governed by the PA outcome, and sets out the disbursement profile based on 100 percent compliance of all LGs with the MMCs and the PAs.

Table 1.3: Annual Unconditional Grants Disbursement Mediated by the MMCs and the PAs

CY	2015		2016		2017		2018		2019	
US$ Total	22.1		33.15		44.2		60.775		60.775	
%/US$	%	US$	%	US$	%	US$	%	US$	%	US$
MMCs	100	22.1	100	33.15	100	44.2	40	24.31	40	24.31
PAs	0	0	0	0	0	0	60	36.465	60	36.465

38. **The PA component of the performance system will be detailed in a Performance Assessment Manual** that will be finalized and approved by June 30, 2015 and will be made fully operational in 2017 for determining disbursements for 2018. The objectives, contents and procedures of the PA manual will be introduced to the LGs through a series of regional workshops during the remainder of 2015. It will then be tested in 2016, in the form of a full-scale "dry run", and the results will be published to enable the LGs to determine their performance and, using capacity support offered under the Program, prepare an Action Plan to address areas where improvements are required. Concurrently, the process and content of the PA as operated under the dry run will be evaluated by an independent study commissioned by the CGSP and the PA manual will be adjusted to take account of the findings of the study.

39. **The PA will address the following areas of LG competence**:

- **Governance**, comprising consideration of: (i) participatory planning and budgeting; (ii) transparency in LG operations (access to information regarding: capital expenditures/consistency with budget, contract awards, investment implementation progress, financial statements/audits); (iii) procurement (timeliness, efficiency and in accordance with regulations); (iv) safeguards (planning and implementation procedures) and (v) response to complaints;
- **Sustainability**, including: (i) asset inventory in place, asset management including O&M plans established annually and implemented; (ii) where required, Financial Recovery Plans (FRPs) prepared and being implemented; (iii) own source revenue collection enhancement plans prepared and being implemented; and (iv) preparation and implementation of capacity building plans; and
- **Management** addressing: investment implementation; financial management practices and satisfactory audits.

B. Conditional Capital Grants for Improving Access to Municipal Infrastructure in Disadvantaged Neighborhoods

40. The conditional grant sub-window provides resources for investments in local infrastructure services in targeted disadvantaged neighborhoods, with funding levels modulated by the participating LGs' ability to meet MMCs applicable to conditional grants that comprise the basic grant access element of the performance assessment system.

41. This conditional capital grant represent a vehicle for the Government to address policy priorities. Currently Government priority is focused on upgrading service levels in disadvantaged neighborhoods. A total of TDN225 million has been allocated under conditional grants for the PIC 2014-2019 period for this purpose. Due to resource constraints and the uneven distribution of disadvantaged neighborhoods across LGs in the country, a regional consultation process (involving elected officials, city representatives, civil society, deconcentrated agencies) was undertaken to pre-identify neighborhoods and LGs that would qualify to receive these grant funds during the CY2014-2019 cycle. LGs currently covered by ongoing urban upgrading programs are not targeted by the Program.

42. As a result of this regional consultation/selection process, 144 LGs comprising 229 neighborhoods have been pre-identified, and a preliminary estimate of the infrastructure requirements boundaries, number of households and costs has been established. To update these estimates and confirm their viability and scope, each participating LG will prepare a pre-feasibility study that will include participation of the affected communities, and will take into account the services to be improved, the size of the population and the level of poverty (requiring a brief survey), the levels and construction standards to be applied, the boundary of the selected neighborhoods, preliminary cost estimates, and the timeline for preparing and implementing the investments. Subject to the findings of the pre-feasibility studies, the LG councils will consider and, if approved, include the proposed investments within the framework of their annual plans and budgets.

43. The application of the performance system to the conditional grants is limited to the MMCs and then only on a one-time basis for the year when the construction of the approved upgrading plans is projected to commence. The same above MMCs for the unconditional apply the conditional grants**.** However, they are applied differentially. For the unconditional grants, it is an annual requirement and each LG has to meet the MMCs relevant for the forthcoming year in order to access any of the unconditional grant funds. Under the conditional grants, it is applied on a neighborhood-by-neighborhood basis for each targeted LG, and is a one-time requirement to access the conditional grants for that neighborhood. The MMCs relevant for the year in which the conditional grants are being sought are applied, but subject to the following additional provision: the completion of a pre-feasibility study (according to a format included in the Program Operations Manual) by each participating LG, and its approval by the LG council.

C. Capacity support for improved LG institutional development and accountability

44. The Government's approach to capacity building in the LG sector is to address needs of the LGs, themselves, as well as key elements of the institutional framework, including operating systems, within which the LGs function. Higher levels of Government have a critical role to play in creating an enabling environment for municipalities, through providing sound regulatory frameworks, capacity support, and regular and effective appraisal and oversight.

45. The capacity support would contribute to the LGs ability to achieve the standards required under the performance assessment system in order for them to access their full entitlement to the capital grants. It will focus on the key support required to assist municipalities to achieve MMCs and performance criteria, and thus contribute to the achievement of the Program Development Objective.

46. Given the heterogeneous demand from municipalities, capacity and technical support will be provided based on an annual LG Capacity Development Plan (LGCDP) that will be prepared by each LG to address its needs. A preliminary capacity needs assessment was carried out during Program preparation and four broad areas were identified as requiring capacity building support at the city level including: (i) municipal investment prioritization and planning, including citizen participation and oversight; (ii) financial management including own source revenue enhancement; (iii) project quality, including procurement and environmental and social management; and (iv) asset management systems and mechanisms for operations and maintenance. The LGCDPs will be

supported through formal training provided by CFAD, and will include targeted courses that will be developed and introduced by CFAD as the need presents itself over the course of Program implementation. In addition the LGCDPs will be supported by a system of "just-in-time" technical assistance to assist the LGs in developing the capacity to handle those key functions that are considered core to the effective operation of sound local Government, and which will be central to the PA system. These LGCDPs will include the LG's estimates of its needs for such technical assistance, but the "just-in-time" system will also be designed to respond quickly to demands as they arise, even if not anticipated in the LG's LGCDP.

47. In addition to operating its current LG/decentralization training programs, CFAD will: (i) undertake a country-wide program to ensure that the councilors and the senior technical staff of all the LGs are fully familiarized with the principles and operating procedures of the new grant system under the Program, and of the capacity support assistance available to them; and (ii) develop and deliver additional training programs that target gaps in areas of LG responsibility that affect their performance and that may be identified during Program implementation, particularly those that emerge through the performance assessment system.

48. The just-in-time program will be managed by the 6 regional offices of the CPSCL, supported with consultancy contracts with firms that would be structured around the principle of providing expertise as needed, and that would be staffed with the requisite expertise to cover participatory planning, budgeting and accountability systems; financial management; technical aspects of planning, project preparation and implementation; procurement; asset management; and environmental management and social safeguards. The LGCPDs prepared by each LG would serve as the basis for determining the scope of the contracts and for logistical planning purposes.

49. The Program will also support the introduction of several initiatives that will focus on those central institutions and systems that have significant roles in the effective operation of LG in Tunisia, and which will strengthen the Government's decentralization, participatory governance and transparency agenda as established under the new Constitution. This will include support for: (i) the design and launch of a new e-Portal (*Portail des Collectivités Locales*) which will make budget, procurement and audit information for all LGs as well as the results of LG performance assessments accessible to the public (and progressively, the E-Portal will also host LGs' information on Participatory Planning and Participatory Budgeting processes), (ii) the expansion of the Court of Auditors (*Cour des Comptes*)' annual LG financial auditing function to increase annual coverage so that by the end of the Program 80 percent of financial accounts legally received by the Court of Auditors (*Cour des Comptes*) from the LGs are being audited annually; (iii) the introduction and operationalization of the annual PA, to be undertaken by the *Contrôleur Général des Services Publics (CGSP)*; and (iv) the delivery of a series of nation-wide workshops by CFAD with assistance from DGCPL and CPSCL to introduce and familiarize the LG system (LGs, relevant institutions and Government agencies, and the general public) with the Program and PA process. Table 1.4 summarizes the capacity building arrangements under the Program.

Table 1.4: Capacity Building Arrangements under the Program

Area of Support	Description	Responsibility	Timing
Formal LG Training	Formal training programs addressing the functioning of decentralization systems and the operational responsibilities of LGs, for both elected officials and staff;	CFAD	Formal system already operational
Technical Assistance to LGs	Program of on-the job, just-in-time assistance provided to LGs on a demand-driven basis. Designed around principle of "learning by doing" and structured to provide expertise in key areas of LG need (finance, technical/engineering; social/citizen participation/accountability; fiduciary)	Caisse with assistance of CFAD and DGCPL	Offers opportunity of quick impact and "early wins". Should be fully operational in time for start of 2015.
Targeted Initiatives to Strengthen LG System	• Systematization of LG financial auditing of LGs • Introduction and operationalization of Performance Assessment (PA) System • Introduction of E-Portal to improve access to information to enhance LG accountability to citizens, and to strengthen DGCPL oversight (M&E) • Nation-wide workshops to introduce and familiarize LG system with Program and PA system • Targeted training for LGs (proc, safeguards, other – as needed)	• Cour Des Comptes • CGSP or CGF • DGCPL • CFAD • CFAD	• 2015 • 2016 • 2015 • 2014 • 2015

50. Consistent with the Government's decentralization agenda focusing on governance and transparency, the Program will also support the introduction of participatory planning and budgeting.

51. **Participatory Planning**. The Program will support the introduction of participatory planning in all 264 LGs beginning in the first year. The participatory planning approach will strengthen citizens' engagement with their municipal councils on capital investments and enhance local accountability and transparency. The approach introduces requirements that LGs present the proposed five-year and annual investment plans and associated budgets to residents in public Town Halls for discussion and input. LGs are required to obtain resident validation of the proposed Plan, or of a modified form of the plan, in the town hall meeting. The validated form of the plan will then be publicly disseminated in a variety of media. Capacity building and just-in-time support will be provided to LGs in preparing for and implementing the participatory planning process, including, importantly, on participatory planning, communications strategies, organization of public Town Hall meetings, and mediation.

52. **Participatory Budgeting.** Participatory budgeting works to increase citizens' engagement with their Governments and introduces them to the principles of public decision-making and budgeting. The Program will support the design and adoption of a participatory budgeting initiative beginning

the first year of the Program, at which point LGs may choose to introduce the approach. Given many LGs' interest in strengthening citizens' engagement, it is anticipated that a fair number will adopt participatory planning in the early years of the Program. As of year 4, however, the performance criteria will reward adoption of participatory budgeting. The participatory budgeting initiative will provide a strong incentive for residents to engage with their LGs since it permits them to directly decide how to spend a portion of the capital grant. LGs adopting participatory budgeting will be required to earmark five percent of their annual allocated capital investment grant for small-scale infrastructure projects proposed by residents and local civil society groups. All residents will be eligible to develop project proposals following pre-established guidelines and proposal templates. The guidelines will make it clear that proposals supporting gender-sensitive community infrastructure will receive additional weighting. All proposals complying with the guidelines will qualify to be presented at in an open public assembly where attendees will cast votes for their selected project proposals. Proposals receiving the most votes will be selected for implementation, up to the five percent budget envelope. The LG is responsible for implementing the selected proposals.

53. **Access to Information.** The Program will support the design and launch of a new E-Portal (*Portail des Collectivites Locales*) which will make budget, procurement and audit information for all LGs accessible to the public. Progressively, the E-Portal will also host LGs' information on participatory planning and participatory budgeting processes.

Program beneficiaries

54. The primary beneficiaries are the 264 LGs and their seven million urban citizens (or 2/3 of the country's total population). They will benefit from enhanced inter-governmental fiscal transfers and from demand driven institutional and capacity development activities which will strengthen their ability to deliver municipal infrastructure and services efficiently and consistent with their citizens' priorities. They will also benefit from initiatives to build knowledge and capacity of municipal council members and municipal staff on participatory governance initiatives which will underpin broader efforts to strengthen municipal efficiency and build a social contract between citizens and their LG. The participation of local communities including, importantly, women and youth, in planning development activities managed by the LG will ensure that vulnerable groups' needs are addressed, further fostering ownership and contributing to long term sustainability.

55. The secondary beneficiaries are people living in 229 underserviced/disadvantaged neighborhoods (more than 500,000 inhabitants in 144 targeted LGs). The main benefits will come from improved access to municipal services, overall improved municipal management and direct involvement of the population in setting investment priorities, and hence in improving their living conditions. Investments activities financed with project funds will benefit this entire target group either directly or indirectly, including through creation of temporary employment which is likely to benefit youth particularly.

Program financing

56. The total outlay of Program and the Government indicative allocations among the three Program elements are presented in Table 1.5 below. The IBRD loan of US$ 300 million represent about 83 percent of the total cost of the Program (US$363 million).

Table 1.5: Program Elements

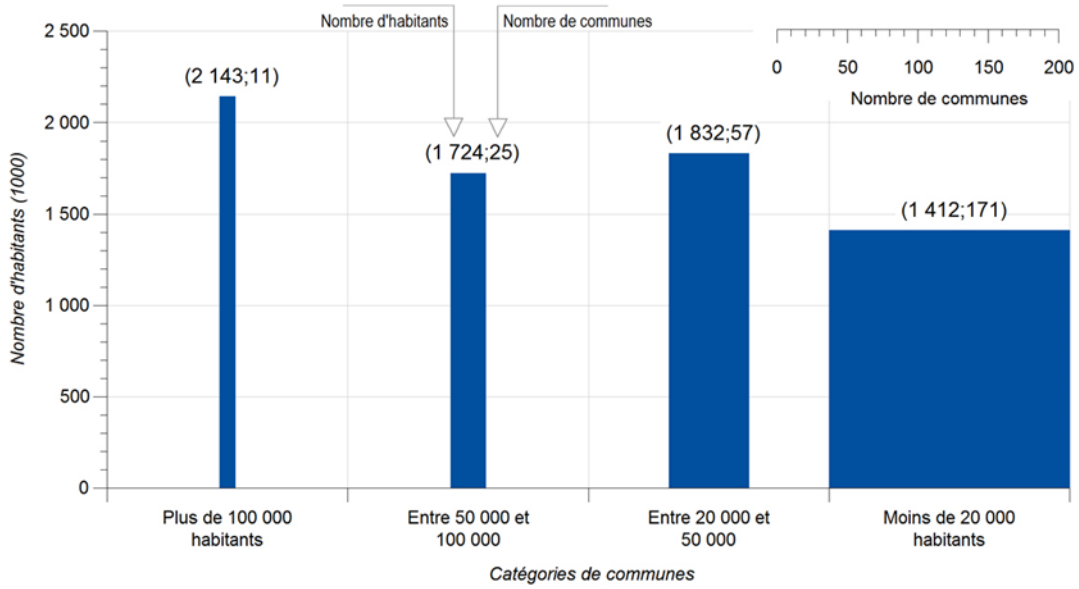
	Amount (TND Million)	Amount (US$ Million)[17]
Capital Grant for Municipal Infrastructure Delivery	305	203
Capital Grant for improving municipal infrastructure in disadvantaged neighborhoods	225	150
Capacity support for improved LG institutional development	15	10
Total Program Financing	**545**	**363**

[17] Exchange rate: 1USD = 1.50 TND

Annex 2 : Financial Status of Local Governments in Tunisia[18]

1. The average size of the 264 municipalities (local governments - - LGs) comprises about 30,000 people. However the distribution of this population between large and small LGs is highly uneven, with 65% (171) LGs on average each housing less than 20,000 inhabitants, and accounting for 20% of the total LG population (1.4 million people). At the other end of the population distribution spectrum, 11 LGs (4% of the total number of LGs) accommodate 30% of the urban population (2.1 million people). This distinction has significance for the management of the urban economies, while also emphasizing the importance of the mid-size LGs, which accommodate half the urban population. Table 2.1 summarizes the population distribution across the LGs in Tunisia.

Table 2.1: Distribution of Communes by Category According to the Number of People (2012)



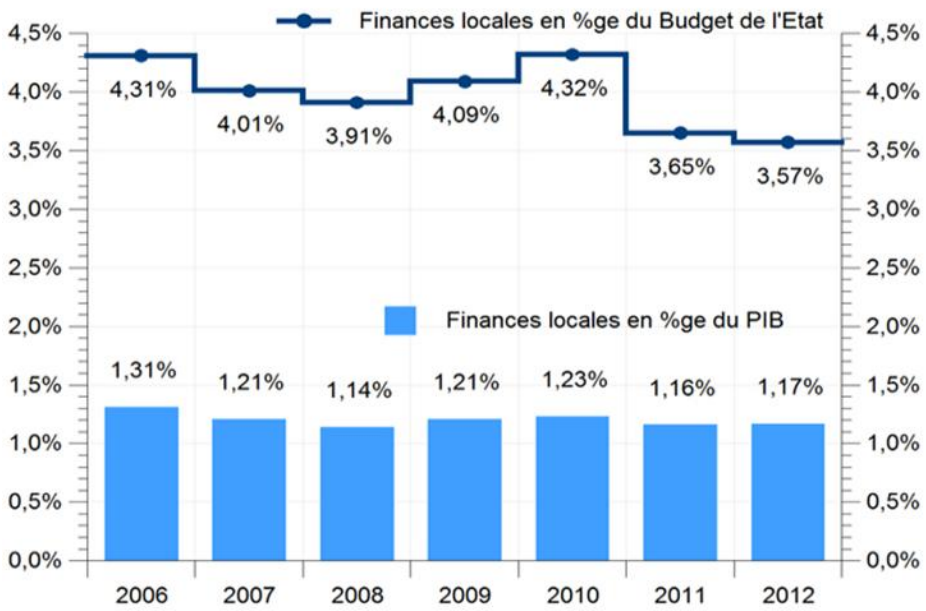
2. While the distribution of population across the different LG sizes represents an important factor in determining development policies for Tunisia and for addressing the development needs of individual LGs, the LG sector more generally faces several critical financial challenges.

A. The LG Sector is Severely Under-Resourced in Tunisia

3. Currently LG in Tunisia is severely under-funded. This is demonstrated in Table 2.2, which examines the declining trend in local revenues as a share of GDP, and as a share of the national budget.

Table 2.2: Trend in LG Revenue Generation as a Share of GDP and the National Budget

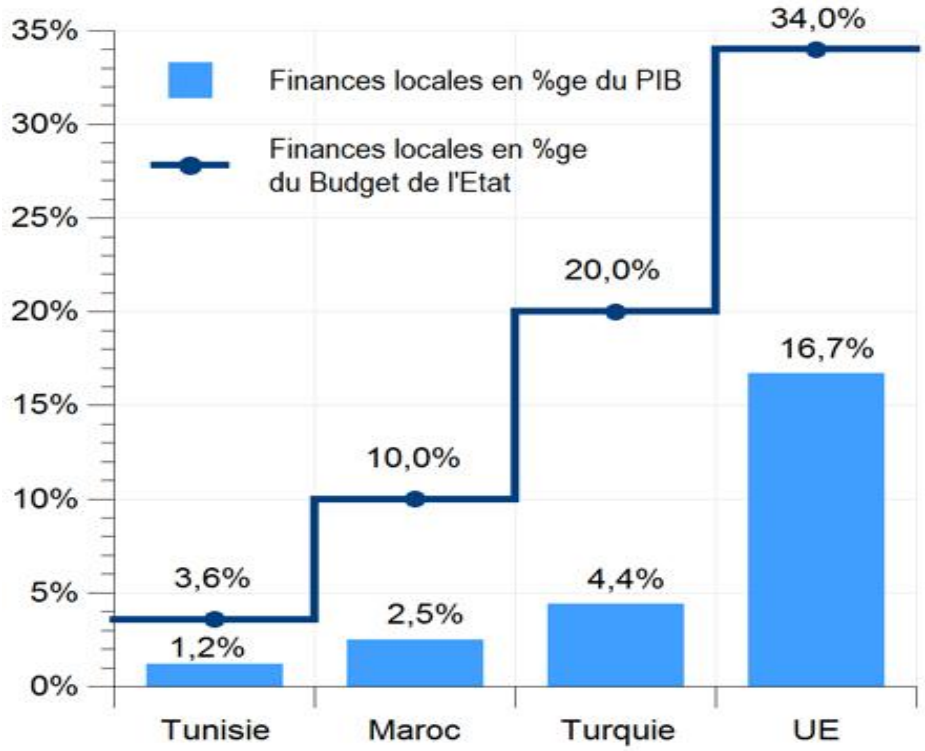
[18] *Extract from draft report on Tunisia PPP in Municipal Services prepared by Nodalis and funded by Islamic Development Bank*



Source: Author's calculations based on data from the Ministry of Interior (*DGCPL) and the MoEF*

4. When total revenues for LG in Tunisia are compared to total LG revenue streams available in other countries of different economic strength (GDP) and at different levels of urbanization, the contrast is even more stark, as shown in Table 2.3.

Table 2.3: Tot LG Revenues in Tunisia compared to Morocco, Turkey and EU.



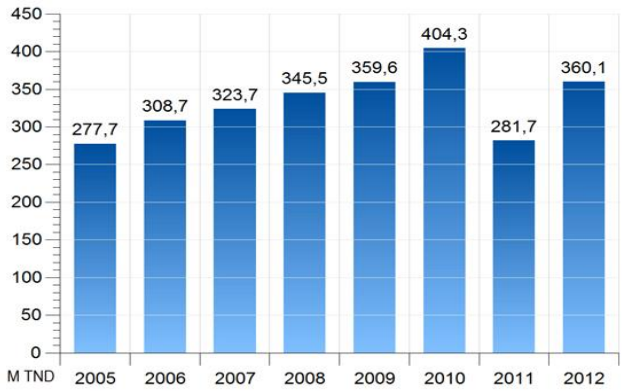
5. Even countries that are far less urbanized, as well as having broader functional assignment are better resourced than Tunisia. For example, Senegal, which has a GDP only one third the size of Tunisia at purchasing power parity, has significantly greater service delivery responsibilities, enjoys an average tax level which is 70% that of Tunisia

6. ***The Program response to resource constraints.*** Taking these constraints into account, the Program design recognizes that current economic pressures require a modulated approach to reforming policies affecting the share of fiscal resources assigned to the LG sector, despite strong pressure for improved local services. Consequently, the Program provides for: (i) the establishment of the fiscal architecture that will facilitate scaling up of resource flows to LG as national fiscal capacity strengthens and as LG performance improves; (ii) the maintenance of historic levels of investment in local services so that service standards are sustained during the economic transition, and reasonable levels of local demand can be addressed; and (iii) the introduction of capacity building systems and LG performance measurement programs that will demonstrate enhanced capabilities of LGs to assume greater service delivery reponsibilities.

B. LG Revenue Management is Weak

7. As indicated in Table 2.4 below, local revenue generation rose slowly between 2005 and 2010, fell dramatically in 2011 following the revolution, and began recovering in 2012. However, annual increases have occurred in nominal terms only, with real levels actually falling or remaining static.

Table 2.4: Trend in LG Revenues (2005-2012)



Source: Based on data from the Ministry of the Interior (DGCPL)

8. When the revenue sources are unpacked, it becomes evident that virtually all revenue instruments have remained flat even in nominal terms. In particular, property taxes, normally the most buoyant revenue source, has remained relatively unchanged over the past 7 years, as have all other sources with the exception of institutional taxes, which in turn reflects continuing heavy reliance on public sector funds. Table 2.5 sets out the trends in revenue generation by sub-category, both in terms of own sources and public subsidies.

Table 2.5: Trend in LG Revenue Generation (2006-2012)

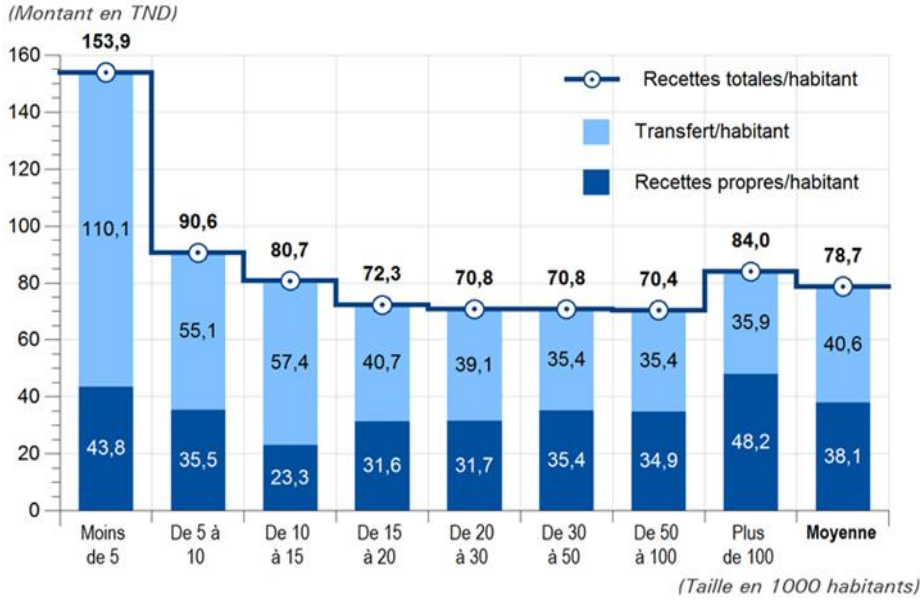
(in millions TND)	2006	2007	2008	2009	2010	2011	2012
own resources							
Tax on buildings	53,5	28,2	32,9	36,2	39,4	19,9	30,0
Tax on undeveloped land	12,4	8,5	10,8	13,6	14,9	11,6	13,7
Institutional tax	68,1	85,7	88,7	93,5	111,1	93,0	136,7
Hotel tax	18,1	22,4	21,4	19,7	22,1	12,0	15,2
Market products	50,0	52,4	58,3	60,0	62,0	36,9	43,9
Electricity surcharge	26,8	30,0	26,9	25,5	27,1	18,2	24,2
Other income[19]	79,8	96,5	106,5	111,1	127,7	90,1	96,4
Total own resources	**308,7**	**323,7**	**345,5**	**359,6**	**404,3**	**281,7**	**360,1**
Public Subsidies							
Common fund	100,6	103,6	112,2	119,3	131,4	144,3	176,3
Off grants						147,0	95,0
Total public subsidy	**100,6**	**103,6**	**112,2**	**119,3**	**131,4**	**291,3**	**271,3**
Total Resources	**409,3**	**427,3**	**457,7**	**478,9**	**535,8**	**573,0**	**631,4**

Source : Based on data from the Ministry of the Interior (DGCPL)

9. The capacity of LGs to generate local revenues varies widely between LGs better situated (coastal or those enjoying more advantageous economic circumstances) and those with weak economic bases. To some extent this variation is also reflected in city size, though in general, the smallest and largest cities generate the greatest per capita incomes. Public sector subsidy increases for LG recurrent expenditures have remained modest, consistent with the pattern of increases in total OSRs. However, the transfer of subsidies for recurrent costs to LGs has been fairly progressive, with the smallest/weakest LGs (those under 15,000 inhabitants) receiving significantly greater per capita allocations, ranging between TND 55 and TND 110 depending on size, and the larger LGs receiving on average about TND 40 per inhabitant. Table 2.6 summarizes these trends. Table 2.6 also reflects a spike in increased allocations of public subsidies to offset the impact of the events in 2011 and their aftermath in 2012.

[19] "Other income" include non-fixed income generated by commercial activities (slaughterhouses, concessions contracts, rental income), festivities, and cultural events

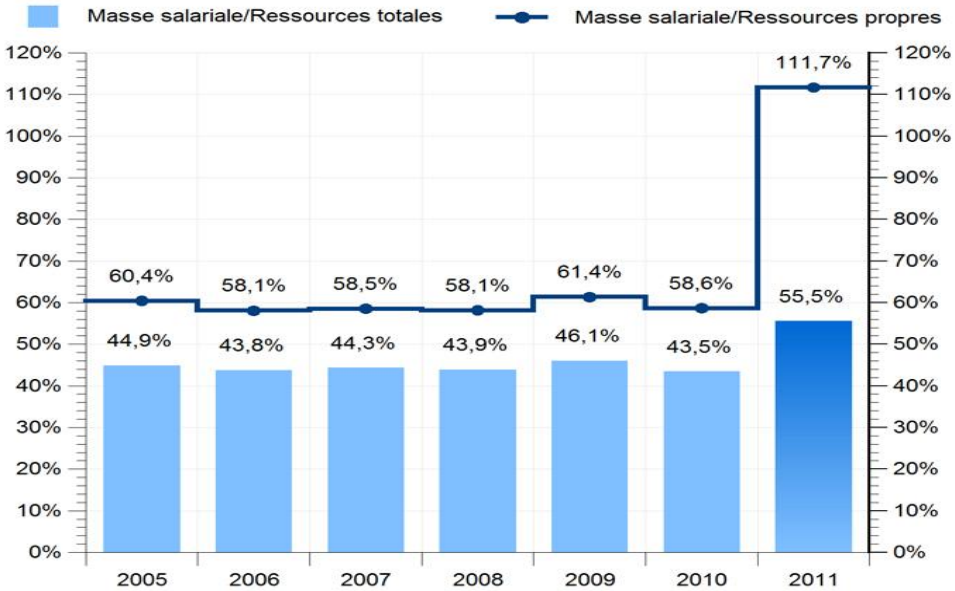
Table 2.6 : Recurrent Revenues per Inhabitant by Categories of LGs Defined by Population Size (2011)



Source: Based on DGCPL and INS data

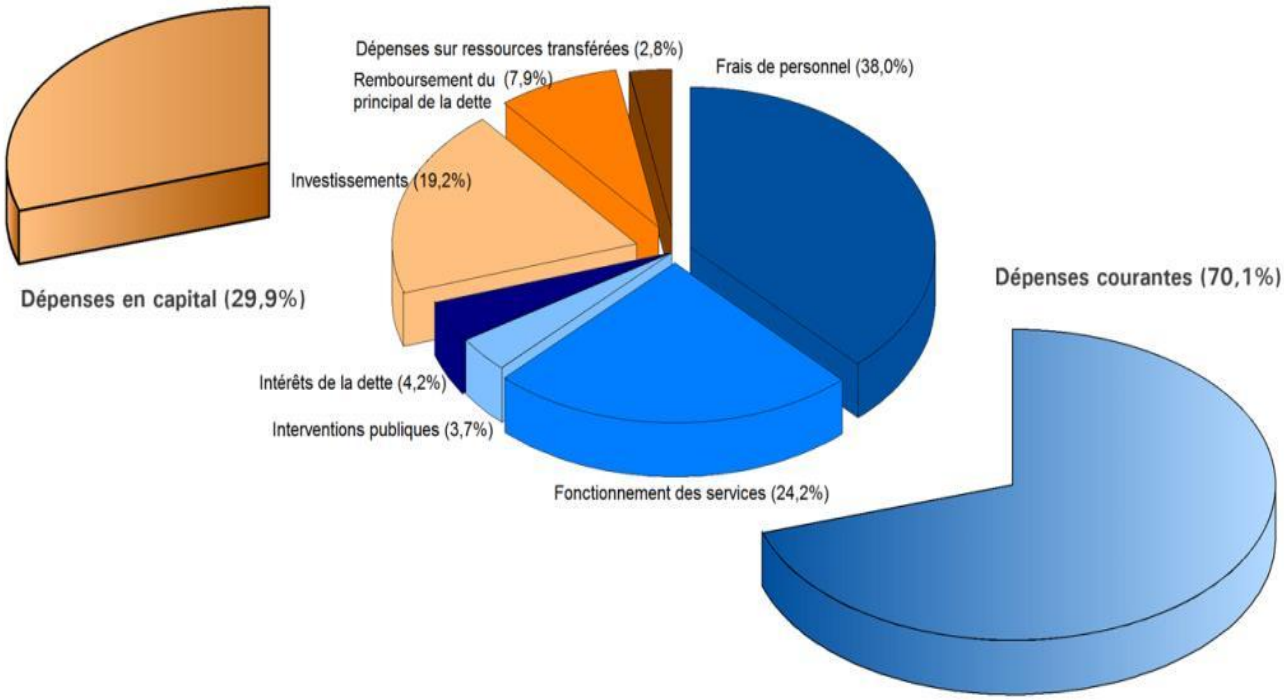
10. Following the revolution the government also introduced policy changes requiring all LGs to absorb part time workers into their permanent staffing establishment. The impact of these changes on LG finances is evident in Table 2.7, with over 110% of locally generated revenues being absorbed by the new salary structure, as compared to the already excessive levels of nearly 60%

Table 2.7: Impact of Payroll on LG Revenues



11. The structure of LG expenditures, set out in Figure 2.1, demonstrates the extent to which investment spending (about 19% of total revenues) is crowded out by recurrent expenditures (over 70% of total revenues), and the significant share of recurrent costs that is represented by the new staffing policy.

Figure 2.1: Structure of LG Expenditures (average 2008-2010)



Source: Based on data from the Ministry of the Interior (DGCPL)

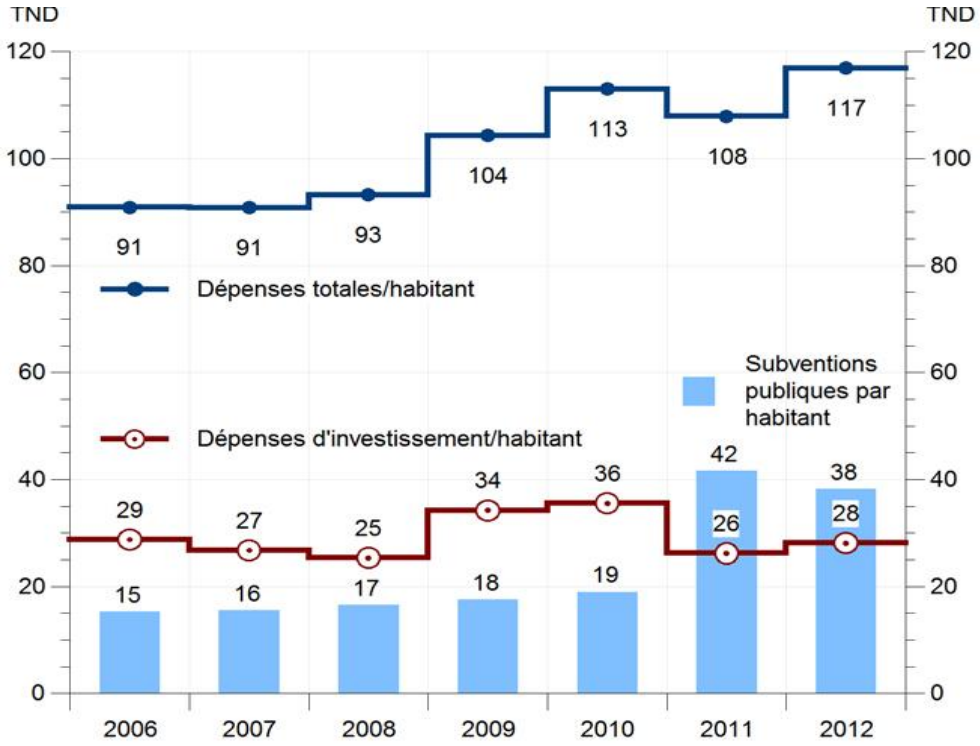
12. ***The Program response to weak revenue management.*** During Program preparation, it was recognized that local revenue management comprised many "moving parts", most of which, in order to make the fundamental changes necessary, involved broader tax reform which touched on difficult policy considerations. It was therefore concluded, since the Program is focusing on reforms to the inter-governmental fiscal architecture, that the strategy dealing with LG revenues would be more modest, and would address two areas: (i) through the fiscal reforms, transfer the ownership for investment decision-making to the LGs, with substantive citizen participation in the process, and subject LG performance to independent annual audits that would be made public, with the objective of creating greater LG accountability and hence establishing durable social contract between LG officials and their electorates. Experience has shown that well functioning social contracts provide the basis for greater willingness to pay for services through the various tax and fee instruments available to LGs; and (ii) under the performance assessment system, include provisions to ensure that enhanced local revenue collection by LGs would be taken into account, in order to incentivize LGs to improve their fiscal capacity.

C. LG Investment Resources are Severely Constrained

13. The trend in funding available for investment in municipal infrastructure by LGs has been severely eroded over the past decade. The erosion is linked in part to the additional operating burdens that have been placed on LGs (eg central government staffing policies for LGs). The net effect of these additional recurrent expenditure obligations on the pattern of LG expenditures is reflected in Table 2.8 where total expenditures per inhabitant has grown from

TND 91 in 2006 to TND 117 in 2012 (a nearly 30% increase), while expenditures on investment per capita have remained virtually static at TND 29 over the same period, even as public subsidies have increased significantly.

Table 2.8: Evolution of Expenditure Ratios and Public Subsidy per Capita



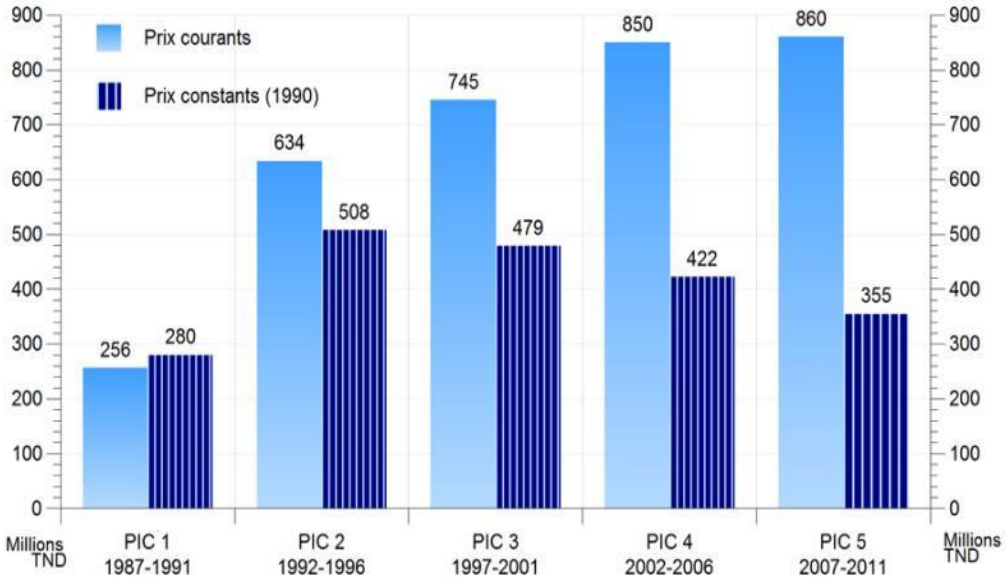
14. In addition, prevailing investment policies have been based on assumptions that have not proven themselves in practice. Most notably has been the provision in the past three PICs (and is evident in the forthcoming PIC) for significant increases in the share of OSRs and loans that would comprise the total investment resource package. Table 2.9 provides the composition of the PICs (OSRs, loans and grants), and compares targeted sources of funds with actual utilization of funding sources, demonstrating that the OSRs and loans have remained flat in nominal terms over a ten-year period, even as grants have increased.

Table 2.9: Comparison of PIC allocations over three PIC cycles (2002 to 2019)[20]

Funding Source	PIC 2002-2006 TDN Million		PIC 2007-2011 TDN Million		PIC 2014-2019 TDN Million
	Projected	Utilized	Projected	Utilized	Projected
OSRs	170.8	124.2	179.1	121.0	193.0
Loans	302.4	257.5	306.0	260.5	389.0
Grants	209.2	214.6	261.1	267.0	305.0
Total	682.4	596.3	746.2	648.5	887.0

15. Despite the increase in grant funds for capital investments by LGs in basic infrastructure within their mandate, the increases have not kept pace with inflationary pressures. Table 2.10 compares the nominal increases with the real increases, demonstrating a substantial erosion of the ability of the LGs to keep pace with demand, exacerbated not only by inflation, but also by the relatively rapidly growing urban population. As a result, investment levels for the 2007-2011 PIC period were significantly less than those for the 1992-1996 PIC cycle.

Table 2.10: Evolution of the CIP Envelope in Nominal and Constant Prices



Source: Based on data from the Ministry of the Interior (DGCPL) and the MoEF

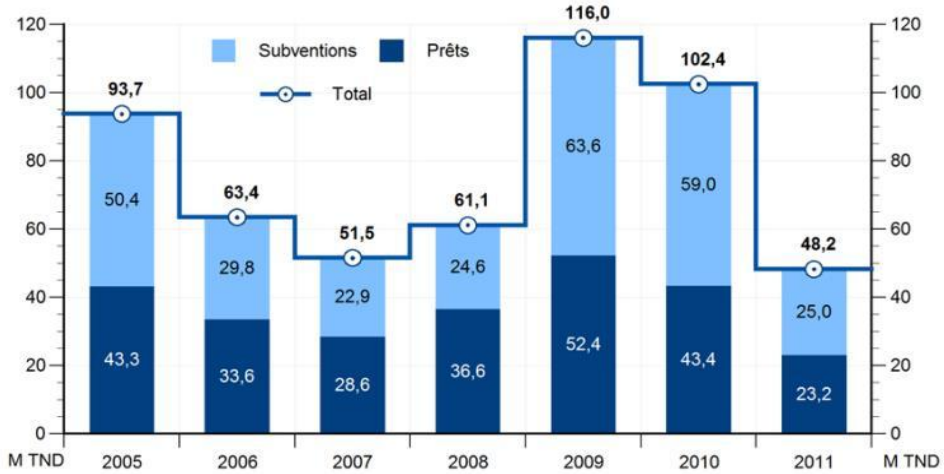
[20] Data provided by the CPSCL; data show a small discrepancy in the Caisse loan amounts between Tables 4 and 5 (about 3%)

16. ***The Program response to constrained investment resources.*** The Program has tackled this issue as follows: (i) it has stabilized the decline and set investment expenditures for the 2014-2019 PIC at similar levels in real terms to the preceding (2012-20140 PIC period which itself saw a substantial increase over 2007-2011. The Program did not seek to increase the level of funding beyond this for the following reasons, all of which are designed to create the platform for significant scaling up of local capital resources for LG investment levels: (i) the national fiscus is under significant stress, limiting the availability of budgetary resources; (ii) the Program has introduced significant reforms which will require major changes in institutional responsibilities and practices; and (iii) LG capacity - - a major focus of the Program - - has to be substantially enhanced to ensure the requisite levels of absorptive capacity to manage higher investment levels (and the related operating and maintenance requirements).

D. Increasingly Unsustainable LG Debt.

17. As a consequence of previous policies, access to grant funds was tied to requirements for LGs to enter into loans - - the objective being to use public funds to leverage greater LG investment in municipal services. Table 2.11 summarizes the profile of LG investments, distinguishing loans from grants.

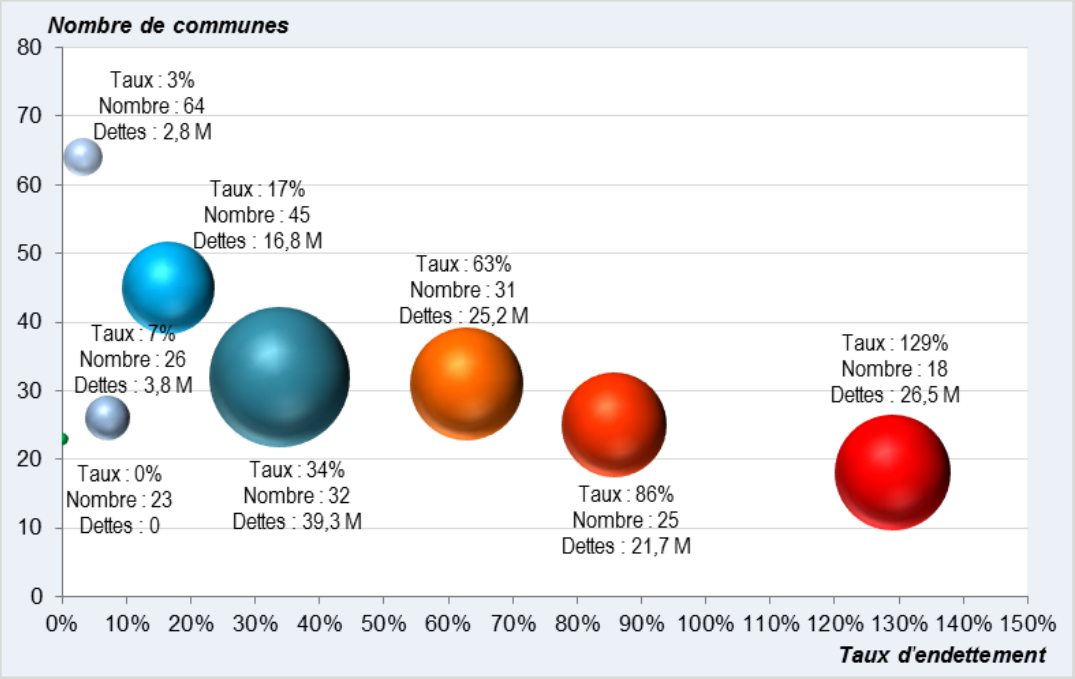
Table 2.11: CPSCL Grants and Loans to Local Municipalities



Source: CPSCL Accounts

18. The policy had many beneficial impacts, but over time has begun to introduce perverse effects that now offset the early benefits. Most notable has been rising LG debt totaling an estimated TND 136 million in 2011. The average municipal debt rate, expressed as a ratio of outstanding debt to income equity, is around 50% and, expressed as a proportion of current income (including transfers of state funds), is 24%. Eighteen LGs have debt ratios exceeding 100% (average ratio of 129%) corresponding to a debt ratio envelope of TND 26.5 million. Twenty-five LGs have debt ratios between 75% and 100% with a total debt of TND 21.7 million. Figure 2.2 summarizes the distribution of debt by LG groupings.

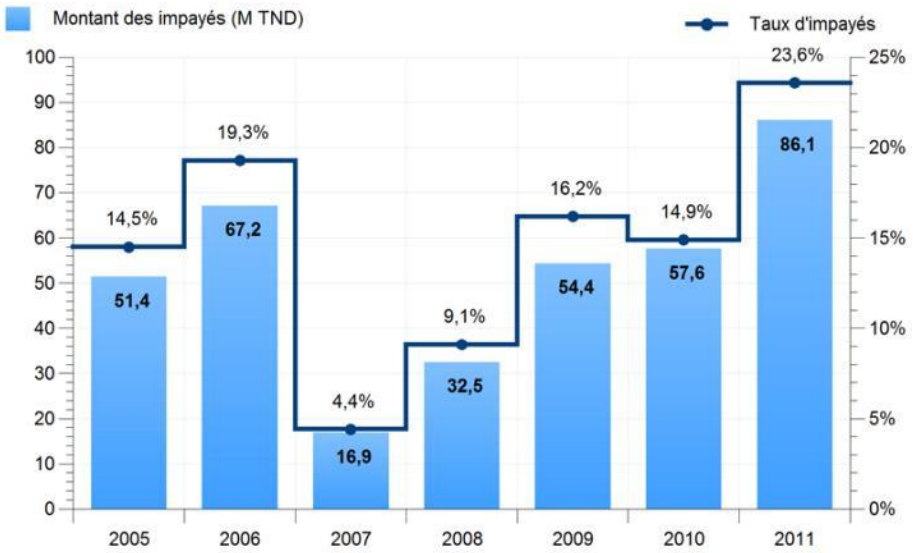
Figure 2.2: Distribution of Communal Categories According to their Debt



Source: Based on data from the DGCPL. The debt ratio is the ratio of debt to total revenue

19. The level of LG debt raises questions of the future financial status of CPSCL, unless lending practices are changed, both o the side of policies that try to crowd in borrowing by kinking grant access to borrowing, and from the perspective of CPSCL rigor in managing its lending practices. Table 2.12 indicates the exposure of CPSCL to arrears which have increased to about TND 86.1 million with the default rate having risen to close to 24%.

Table 2.12: Evolution of CPSCL Arrears



Source: CPSCL Accounts

20. ***The Program response to rising LG debt.*** The focus on the Program on reforming the LG fiscal architecture as it affects capital grants has included three features intended to directly address debt management by LGs: (i) the former regulatory framework tying loans to grants has been restructured so that grant access is independent of loans; (ii) indebted LGs are required to prepare financial performance improvement plans; and (iii) CPSCL is introducing more rigorous lending practices as part the preparation of an updated business plan.

Annex 3: Results Framework Matrix

	Tunisia Urban Development and Local Governance Program – Results Framework													
Indicator	**Core**	**DLI**	**Unit of Measure**	**Base-line**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**Freq-uency**	**Method**	**Responsibility for Data Collection**
	The objectives of the Program are: (i) to strengthen Local Governments' performance to deliver municipal infrastructure, and (ii) to improve access to services in targeted disadvantaged neighborhoods.												
	PDO Level Results Indicators												
Percentage LGs that achieve at least 70% score in their annual performance assessment [21]	☐	☒	%	0	N/A	N/A	N/A	50	60	70	Annual	PA	CPSCL, CGSP
People living in targeted disadvantaged areas benefiting from improved municipal infrastructure (disaggregated by gender)	☐	☐	Number	0	0	0	00	150,000	300,000	500,000	Annual	LG Progress Reports PPR	LG, CPSCL
Number of Direct Beneficiaries of	☒	☐	Number	0	0	7,000,000	7,000,00	7,000,000		7,000,000	Annual	LG Progress	LG,

[21] Performance areas include: Governance, sustainability and management.

which 50% women							0		7,000,000			Reports PPR	CPSCL
	Intermediate Results Indicators													
	Result Area 1: Capital Grant System reformed													
Capital grant system restructured through the amendment of Decree 97-1135	☐	☒	Yes/No	No	Yes	N/A	N/A	N/A	N/A	N/A	Once	Amended Decree published in the Official Gazette	MoI
Timely publication of indicative unconditional capital grant allocation for each LG	☐	☒	Yes/No	No	No	Yes	Yes	Yes	Yes	Yes	Annual	E-portal and/or website	DGCPL, CPSCL
LGs that satisfy Minimum Mandatory Conditions (MMCs) and receive capital grants	☐	☒	%	0	N/A	60	70	80	90	90	Annual	Independent verification report	CPSCL, Verification Entity
	Results Area 2: LG institutional performance improved to deliver municipal infrastructures and services													
Independent LG performance assessment system introduced and threshold targets met.	☐	☒	Yes/No	None	No	No	No	Yes	Yes	Yes	Annual	Program performance report	CPSCL

LGs that have executed their Annual Investment Plans on schedule in terms of expenditures	☐	☒	%	35	N/A	40	50	60	70	80	Annual	Program performance report	CPSCL
LGs that received Capacity Building Support in accordance with their annual capacity development plan	☐	☒	Number	0	N/A	50	60	70	80	80	Annual	Program performance report	CPSCL, CFAD
Information on fiscal transfer and LG performance is publicly accessible	☐	☐	Yes/No	None	No	No	No	Yes	Yes	Yes	Annual	E-portal	DGCPL
	Results Area 3: Access to municipal infrastructure in targeted disadvantaged areas improved												
LGs that implement their investment plans for targeted disadvantaged	☐	☐	%	0	0	0	30	60	80	100	Annual	Program performance report	LG, CPSCL

neighborhoods according to schedule													
People in urban areas provided with access to all-season roads within a 500 meter range under the program[22]	☒	☐	Number	0	-	-	-	-	-	-	Annual	Program performance report	LG, CPSCL
People in urban areas provided with access to regular solid waste collection under the program	☒	☐	Number	0	-	-	-	-	-	-	Annual	Program performance report	LG, CPSCL

[22] Targets to be established once the neighborhood upgrading programs are selected.

Annex 4: Disbursement Linked Indicators, Verification Protocols, and Disbursement Arrangements

Table 4.1: Disbursement Linked Indicators

DLI	Total DLI Allocation (Million US$)	As % of Total Financing Amount	DLI Baseline	Timeline for DLI achievement					
				2014	2015	2016	2017	2018	2019
Reform of the Capital Grant System									
DLI 1 The Government has replaced Decree No 97-1135 and restructured its capital grant system accordingly	30	10%	None	Yes	N/A	N/A	N/A	N/A	N/A
Allocated amount for DLI 1				*30*	*0*	*0*	*0*	*0*	*0*
DLI 2 Timely communication to LGs of the indicative Capital Block Grants (CBGs) allocation and timely transfer of CBGs to eligible LGs by	20	6.7%	None	N/A	Yes	Yes	Yes	Yes	Yes

the Government									
Allocated amount for DLI 2				*0*	*4*	*4*	*4*	*4*	*4*

Strengthened Local Government Institutional Performance and Municipal Infrastructure Delivery									
DLI 3 Acceptable percentage of LGs have met the MMCs and received CBGs	30	10%	0	N/A	60%	70%	80%	90%	90%
Allocated amount for DLI 3				*0*	*6*	*6*	*6*	*6*	*6*
DLI 4 The Government has designed and implemented an independent LG performance assessment (PA) system and required percentage of LGs have met the threshold PA scores	90	30%	None	N/A	Performance Assessment Manual adopted by Circular of the Minister of Interior	Performance Assessment Dry Run	50% of LGs achieve threshold PA scores	60% of LGs achieve threshold PA scores	N/A
Allocated amount for DLI 4				*0*	*20*	*20*	*25*	*25*	*0*
DLI 5 Required percentage of LGs have executed their Annual Investment Plans on schedule in terms of	45	15%	None	N/A	40%	50%	60%	70%	80%

expenditures									
Allocated amount for DLI 5				*0*	*5*	*10*	*10*	*10*	*10*
DLI 6 Required percentage of LGs have received capacity building support in accordance with their annual capacity development plan	25	8.3%	None	N/A	50%	60%	70%	80%	N/A
Allocated amount for DLI 6				*0*	*5*	*5*	*10*	*5*	*0*

Improved access to municipal infrastructure in disadvantaged neighborhoods									
DLI 7 Targeted number of people living in targeted disadvantaged neighborhoods have benefited from improved municipal infrastructure	40	13.3%	0%	*Disbursement from the Bank for DLI 7 will be calculated based on milestones reached on individual sub-projects. The schedule for achieving milestones and corresponding disbursement below are indicative only.*					
				N/A	Works contracts tendered are covering 20% of the target population	Works Contracts tendered are covering 50% of targeted population	Works Contracts tendered are covering 85% of targeted population Works Contracts covering 30%	Works Contracts tendered are covering 100% of targeted population Works Contracts	Works Contracts covering 100% of targeted

							of targeted population are completed	covering 60% of targeted population are completed	population are completed
Allocated amount for DLI 7				*0*	*1.6*	*2.4*	*12.4*	*10.8*	*12.8*
Strengthening of Local Government Systems									
DLI 8 Transparency and access to information improved	20	6.7%		N/A	E-portal hosted by the DGCPL designed and operational	At least 60% of LG annual financial accounts legally received by the Cour des Comptes are audited by September 30 of current year	At least 70% of LG annual financial accounts legally received by the Cour des Comptes are audited by September 30 of current year	At least 80% of LG annual financial accounts legally received by the Cour des Comptes are audited by September 30 of current year	N/A
Allocated amount for DLI 8				*0*	*10*	*3*	*3*	*4*	*0*

Table 4.2: DLI Verification Protocol

DLI	Definition/ Description of achievement	Scalability (Yes/No)	Protocol to evaluate achievement of the DLI and data/result verification		
			Data source / agency	Verification Entity	Procedure
DLI 1 The Government has replaced Decree No 97-1135 and restructured its capital grant system accordingly	By Program effectiveness, Decree 97-1135 amended to reflect the core elements of the capital grant reform incl. introduction of the formula based allocation; timely publication and transfer of annual allocation; use of capital grant at the discretion of LG, progressive implementation of annual and independent LG performance assessment	No	MoEF	Bank with support from IVA	Submission to the Bank of approved decree reflecting the core elements of the CGS reform and its publication on the Official Gazette.
DLI2 Timely communication to LGs of the indicative Capital Block Grants (CBGs) allocation and timely transfer of CBGs to eligible LGs by the Government	From Program year 2 onwards, Annual allocation of CBGs published no later than Dec 1 of the preceding year and disbursed no later than Feb 1 of the current year	No	CPSCL	Bank with support from IVA	From Program year 2, the CPSCL will notify the Bank of the date and means of publication of the annual allocation and will submit the documentation relative to the disbursements. Verification by the Bank with support from the IVA that the annual allocation is consistent with the provisions of the decree, that the indicative annual allocation of capital block grants has been timely communicated to LGs to use the information for the preparation of their annual investment plan, and that the disbursements have been completed by the target date to eligible LGs.
DLI 3	Annual targets are defined in terms of percentage of LGs	Yes	LGs and	Bank with	Each year, the LGs will communicate to the CPSCL the documentation relative to the satisfaction of

Acceptable percentage of LGs have met the MMCs and received CBGs	meeting the MMCs. The Annual targets are : CY 2015 : 60% of LGs CY 2016 : 70% of LGs CY 2017 : 80 % of LGs CY 2018 : 90% of LGs CY 2019 : 90% of LGs		CPSCL / PA	support from IVA	MCC. In the first and the second year of the Program, the CPSCL will review the documentation and determine the compliance of each municipal investment plan with the provision of the Ministerial Decree. Starting from the third year, this review will be fully integrated to the annual performance assessment of LGs to be carried out by the independent entity. The assessment report and supporting documentation will be made available by the CPSCL for the Bank with support from the IVA to carry out a sample audit.
DLI 4 The Government has designed and implemented an independent LG performance assessment (PA) system and required percentage of LGs have met the threshold PA scores	In CY 2015: The PA system is developed and the PA manual is adopted by MoI In CY 2016: the PA system is tested and implemented. In CY2017 50% of LGs achieve threshold PA scores In CY 2018: 60% of LGs achieve threshold PA scores	Yes	CPSCL / PA	Bank with support from IVA	The entity in charge of PA will provide to the Bank through the CPSCL the supporting documentation relative to the achievement of targets for CY 2015, and 2016, and the Performance assessment reports for CY 2017 and 2018
DLI 5 Required percentage of LGs have executed their Annual Investment Plans on schedule in terms of expenditures	Percentage of LGs which have executed at least 70% of the expenditures involved in their annual investment plan. The annual targets are CY 2015 : 40 % of LGs CY 2016 : 50 % of LGs CY 2017 : 60 % of LGs	Yes	CPSCL/PA	Bank with support from IVA	Each year, the LGs will prepare a progress report on the execution of their investment budget. The CPSCL will compile the progress reports in a consolidated progress report for the same year. The Bank with support from the IVA will verify the achievement of the target through sample audits.

	CY 2018 : 70 % of LGs CY 2019 : 80 % of LGs				
DLI 6 Required percentage of LGs have received capacity building support in accordance with their annual capacity development plan	Annual targets are defined in terms of percentage of LGs which have preparedand substantially executed a Capacity Development Plan. The Annual targets are : CY 2015 : 50% of LGs CY 2016 : 60% of LGs CY 2017 : 70 % of LGs CY 2018 : 80% of LGs	Yes	LG / CPSCL / CFAD	Bank with support from IVA	Starting from CY 2015, each LG prepares and executes with the support of the CPSCL and CFAD an Annual Capacity Development Plan (ACDP) covering the same areas covered under the PA. Each LG transmits its final ACDP to the CPSCL by February 15th of the current year. Each LG submits to the CPSCL a progress report on the execution of its ACDP by February 1st of the following year. The CPSCL will submit a consolidated report on the implementation of the LGs' ACDPs for the previous year to the IVA by March 15th of each year. The Bank with support from the IVA will verify the achievement of the target.
DLI 7 Targeted number of people living in targeted disadvantaged neighborhoods have benefited from improved municipal infrastructure.	This is defined as the percentage of the target population for which works contracts have been signed and completed.	Yes	CPSCL	Bank with support from IVA	Each year, the LGs will prepare a physical progress report on investments funded as part of the Program. In addition, the LGs will make available to the CPSCL all documentation relative to each subproject's compliance with the Program's provision on (i) sub-project's eligibility, (ii) feasibility studies, (iii) procurement, (iv) environmental and social management, and (v) inclusion of the assets created in the LG municipal asset management system. The CPSCL will review the documentation and determine the compliance of each municipal investment.

					The CPSCL will submit to the Bank a consolidated report on progress and compliance of the investment sub-projects in targeted neighborhoods. The assessment report and supporting documentation will be made available by the CPSCL for the Bank with support from the IVA to carry out a sample audit.
DLI 8 Transparency and access to information improved	In CY 2015, the E-portal is designed and operational. From CY 2016, annual targets in terms of timely completion (by Sep 30 of the current year) of audits of the financial statements received from the LGs are met.	Yes	DGPCL & Cour des Comptes	Bank with support from IVA	In CY 2015, the DGPCL will submit the final approved design of the E-Portal and a progress report on its operationalization to the Bank through the CPSCL. The Bank with support from the IVA will verify the achievement of the corresponding targets. For CY 2016, 2017, and 2018, the Bank with support from the IVA will refer to the audit reports published by the Cour des Comptes and will verify the achievement of the corresponding targets.

Table 4.3: Bank Disbursement

DLI	Bank financing allocated to the DLI	Of which Financing available for		Deadline for DLI Achievement[1]	Minimum DLI value to be achieved to trigger disbursements of Bank Financing [2]	Maximum DLI value(s) expected to be achieved for Bank disbursements purposes [3]	Determination of Financing Amount to be disbursed against achieved and verified DLI value(s) [4]
		Prior results	Advances				
DLI 1 The Government has replaced Decree No 97-1135 and restructured its capital grant system accordingly	30	30	-	Program effectiveness	N/A	N/A	Yes/No. This is a prior result and disbursement will take place upon program effectiveness.
DLI 2 Timely communication to LGs of the indicative Capital Block Grants (CBGs) allocation and timely transfer of CBGs to eligible LGs by the Government	20	0	0	July 15 of each year for communication of annual allocation. March 1st of each year for grant transfer	N/A	N/A	Yes/No. The sub indicator for each year must be verified in full for the disbursement to occur. If the target is not met for a given year, the undisbursed amount will be redistributed equally in the projected disbursement of next years.
DLI 3 Acceptable percentage of LGs have met the	30	0		December 31st of each year.	30%	CY 2015 : 60 % CY 2016 : 70 %	The achievement of this DLI will be assessed every year for each LG on a Pass/Fail basis. Disbursement from the Bank will proportionate to the

MMCs and received CBGs						CY 2017 : 80 % CY 2018 : 90 % CY 2019 : 90 %	number of LG achieving the DLI. D=A*(C/T)/G *Where:* D= annual disbursement A= annual allocation C= number of LGs compliant T= total number of LGs G= annual goal in percentage (*)= multiplied (/)= divided (>)= greater than (<)= lesser than If C/T < 0.3, D = 0 If C/T > G, D=A If the target is not met for a given year, the undisbursed amount will be redistributed equally in the projected disbursement of the following years.
DLI 4 The Government has designed and implemented an independent LG performance assessment (PA) system and required	90	0	0	December 31st of each year.	N/A for the first three year. For CY 2017 and 2018: 15%	N/A for the first three years CY 2017: 50%	Amount allocated for CY2015, and 2016 targets will be disbursed on a yes/No basis. The sub indicator for each year must be verified in full for the disbursement to occur. If the target is not met for a given year, the undisbursed amount will be disbursed in the next years, when the

percentage of LGs have met the threshold PA scores						CY2018: 60%	target is met. For CY 2017 and 2018 disbursement from the Bank will be determined by the number of LG achieving the threshold PA score as a result of their Annual Performance Assessment. D=A*(C/T)/G Where: D= annual disbursement A= annual allocation C= number of LGs compliant T= total number of LGs G= annual goal in percentage (*)= multiplied (/)= divided (>)= greater than (<)= lesser than If C/T < 0.5, D = 0 If C/T > G, D=A If the target is not met for a given year, the undisbursed amount will be redistributed equally in the projected disbursement of next years

DLI 5 Required percentage of LGs have implemented their annual investment plans on schedule	45	0	30	December 31st of each year.	15%	CY 2015 : 40 % CY 2016 : 50 % CY 2017 : 60 % CY 2018 : 70 % CY 2019 : 80 %	Achievement of the DLI objective of at least 70% implementation of the annual investment plan will be assessed on a Yes/No basis for each LG and disbursement will be proportional to the percentage of LGs passing against the annual target. D=A*(C/T)/G Where: D= annual disbursement A= annual allocation C= number of LGs compliant T= total number of LGs G= annual goal in percentage (*)= multiplied (/)= divided (>)= greater than (<)= lesser than If C/T < 0.15, D = 0 If C/T > G, D=A If the target is not met for a given year, the undisbursed amount will be redistributed equally in the projected disbursement of next years.

DLI 6 Required percentage of LGs have received capacity building support in accordance with their annual capacity development plan	25	0	0	December 31st of each year.	15%	CY 2015 : 50 % CY 2016 : 60 % CY 2017 : 70 % CY 2018 : 80 %	For Program years 2, 3, 4, and 5 targets, the achievement of this DLI will be assessed every year for each LG on a Yes/No basis. The DLI will be achieved for each LG if 70% of the capacity building plan has been completed. Disbursement from the Bank will proportionate to the % of LG achieving the DLI. D=A*C/T *Where:* D= annual disbursement A= annual allocation C= number of LGs compliant T= total number of LGs G= annual goal in percentage (*)= multiplied (/)= divided (>)= greater than (<)= lesser than If C/T < 0.15, D = 0 If C/T > yearly target, D=A If the target is not met for a given year, the undisbursed amount will be redistributed equally in the projected

							disbursement of next years.
DLI 7 Targeted number of people living in targeted disadvantaged neighborhoods have benefited from improved municipal infrastructure	40	0	30	December 31st of each year.	>20,000	500,000	Disbursement from the Bank will be calculated based on milestones reached on individual sub-projects. D=Ps*0.2*U+Pc*0.8*U *Where:* D= total disbursement Ps= Sum of population in disadvantaged neighborhoods for which the contracts have been tendered Pc= Sum of population in disadvantaged neighborhoods for which the works have been completed U= A/Pt A= total allocation Pt= total target population in disadvantaged neighborhoods (*)= multiplied (/)= divided (>)= greater than (<)= lesser than If (Ps*0.2)+(Pc*0.8)<20,000, D=0

							If (Ps*0.2)+(Pc*0.8)> Pt, D=A.
DLI8: Transparency and access to information improved	20	0	0	December 31st of each year.	30%	CY 2016 : 60 % CY 2017 : 70 % CY 2018 : 80 %	Disbursement for CY 2015 allocation on a Yes/No basis. Disbursements for CY 2016, 2017, and 2018 D=A*(K/T)/G *Where:* D = Annual disbursement A= Annual allocation K = Number of annual Audits completed by Sep 30 of each year T = Total Number of LG financial statement legally submitted by LG to the Cour des Comptes G = Annual goal (expressed in percentage of audits completed) (*)= multiplied (/)= divided (>)= greater than (<)= lesser than If K/T < 0.3, D = 0 If K/T > G, D=A If the target is not met for a given

							year, the undisbursed amount will be redistributed equally in the projected disbursement of next years.

Annex 5 : Local Government Mandated Functional Assignments

Investments which fall within the LG mandates and which are listed by the CPSCL as eligible LG functions are summarized in Table 5.1.

Table 5.1: List of functions which fall within the mandate of local governments

Investment category	Examples of projects
Economic Facilities	Municipal markets; commercial centers and shops, parking, slaughterhouses; for profit Recreational parks
Community Facilities	Community facilities including sports facilities (sports fields, sports centers, swimming pools, youth centers, kindergarden), Cultural and recreational facilities (library, movie theater, theater, gallery, museum, zoo).
Basic Infrastructure	Roads and sidewalks, street lighting, storm water drainage, potable water, sanitation (wastewater), maintenance of basic infrastructure
Planning and housing	Servicing of vacant land for economic activities, housing, and rehabilitation of neighborhoods.
Vehicles and equipment	Vehicles and equipment for road maintenance, vehicles and equipment for public transportation, vehicles and equipment for household waste collection, computer equipment.
Administrative buildings and equipment	Town halls, municipal buildings
Environment-oriented projects	Improvements to green spaces, sanitation, recreational parks.
Land acquisition	Land acquisition, buildings.

The following investments are eligible for funding under the Program:

- small or medium scale civil works such as road and drainage construction, rehabilitation and upgrading, and paving;
- street lighting;
- extension/connectivity to public sanitation network;
- storm water drainage;
- solid waste collection;
- park maintenance and establishment of recreation facilities;
- community markets;
- other environmental improvements.

Annex 6: Local Governments eligible to receive funds under the Conditional Grant

Targeted Local Governments and Neighborhoods

Region	Governorate	Municipality	Number of Neighbor hoods	Estim. Number of inhabi-tants
Grand Tunis	Tunis	Le Bardo	1	1,230
		El Kram	1	20,000
	Total Tunis		**2**	**21,230**
	Ariana	Ettadhamen	1	7,200
		Raoued	2	10,000
		Raoued	1	6,000
			1	7,500
			1	2,100
		Raoued	1	6,000
		Kalaat Al Andalous	1	4,000
		Soukra	1	2,000
		Soukra	1	1,250
		Soukra	1	900
		Soukra	1	1,000
		Soukra	1	1,700
		Ariana	1	2,500
	Total Ariana		**14**	**52,150**
	Manouba	Denden	1	1,250
		Djedaïda	1	3,550
		Djedaïda	1	3,550
		Djedaïda	2	2,500

		Oued Ellil	2	2,550
		Oued Ellil	2	3,250
		Mornaguia	1	2,150
		Mornaguia	1	2,150
		Tebourba	1	1,125
		Borj El Amri	1	800
		Douar Hicher	1	750
		Douar Hicher	1	2,550
		Douar Hicher	1	2,550
		Douar Hicher	1	1,100
		Manouba	1	750
		Djedaïda	1	750
			1	450
			1	750
			1	2,000
			1	3,500
			1	1,350
	Total Manouba		**24**	**39,375**
	Ben Arous	Mornaguia	2	1,275
		Rades	1	6,000
		Hammam Chott	1	2,250
		Hammam Lif	1	450
		Ez-Zahra	1	2,000
	Total Ben Arous		**6**	**11,975**
North-East	Zaghouan	El Fahs	1	1,000
		El Fahs	1	1,000
		Zaghouan	1	1,000
		Bir Mchergua	1	2,000
		Ez-Zeriba	2	1,500
		Ez-Zeriba	1	600

		En-Nadhour	2	2,250
			1	3,000
			1	3,000
	Total Zaghouan		**11**	**15,350**
	Nabeul	Beni Khiar	1	5,000
		Somaâ	2	400
			1	5,000
		Grombalia	1	1,700
		Hammamet	1	1,250
		Menzel Temime	3	15,000
		El Mâamoura	1	1,000
		Kelibia	1	3,500
		Korba	1	5,000
		Dar Chaabane	1	4,500
			1	750
		Hammam El Guezaz	1	1,000
		El Haouaria	1	4,000
	Total Nabeul		**16**	**48,100**
	Bizerte	Bizerte	1	3,000
		Menzel Bourguiba	1	4,000
		Mateur	1	2,500
		El Alia	1	1,000
		Sedjnane	1	300
		Tinja	1	2,500
			1	4,000
			1	4,000
	Total Bizerte		**8**	**21,300**
Center-East	Monastir	Moknine	2	10,000
		Amiret Touazra	1	2,330

		Amiret Hojjaj	2	1,550
		Touza	1	1,200
		Sayada	1	7,500
		Zermadine	1	3,200
		Teboulba	1	6,750
		Ksibt El Mediouni	1	1,550
		Menzel En-Nour	1	2,000
		Sahline Môotmar	1	4,380
	Total Monastir		**12**	**40,460**
	Sousse	Zaouiet Sousse	1	1,450
		Sidi El Heni	1	300
		Kalâa Kébira	1	600
		Akouda	1	1,650
		Ksibet Thrayet	1	700
			1	1,350
		Hergla	1	900
		M'Saken	1	2,850
			1	2,500
	Total Sousse		**9**	**12,300**
	Mahdia	Mahdia	1	
		El Bradâa	1	1,500
		Essouassi	1	600
		El Djem	1	1,900
		Ouled Chamekh	1	640
		Melloulech	1	1,620
		Ksour Essef	1	1,560
		Hebira	1	320
		Bou Merdes	1	800
		Chorbane	1	700
		Réjiche	1	2,000

		Sidi Alouane	1	800
	Total Mahdia		**12**	**12,440**
	Sfax	Sakiet Ezzit	1	4,900
		Gremda	1	5,000
		Skhira	1	6,000
		El Hencha	2	5,100
		Kerkennah	2	2,200
	Total Sfax		**7**	**23,200**
North-West	Béja	Béja	1	2,280
			1	1,960
			1	5,130
			1	5,000
			1	5,075
		Goubellat	1	2,550
	Total Béja		**6**	**21,995**
	Jandouba	Oued Meliz	1	1,500
		Fernana	1	470
		Tabarka	1	3,200
		Jendouba	1	2,750
		Bou Salem	1	2,400
			1	1,700
		Beni M'tir	1	133
	Total Jandouba		**7**	**12,153**

	Le Kef	Sakiet Sidi Youssef	1	3,850
		Es-Sers	1	5,250
		Dahmani	1	4,250
		Djerissa	1	1,800
		El Ksour	1	3,450
		Menzel Salem	1	800
			1	1,200
		Touiref	1	1,600
	Total Le Kef		**8**	**22,200**
	Siliana	El Aroussa	1	1,800
		Er-Rouhia	1	2,100
		Gaâfour	1	1,250
			1	1,250
		El Krib	1	3,000
		Bargou	1	2,500
			1	3,650
			1	1,500
	Total Siliana		**8**	**17,050**
Center-West	Kairouan	Kairouan	1	6,000
		Kairouan	1	2,200

			1	850
			1	2,000
			1	2,000
			1	3,000
			1	2,000
			1	2,500
			1	850
		Nasrallah	1	2,200
		Menzel Mehiri	2	1,200
	Total Kairouan		**12**	**24,800**
	Sidi Bouzid	Sidi Ali Ben Aoun	1	1,800
		Mezzouna	1	750
		Meknassy	1	6,000
		Jilma	2	3,500
		Regueb	1	1,000
		Menzel Bouzaine	1	3,750
		Ouled Haffouz	1	850
		Bir El Hafey	1	2,820
		Cebalet	1	1,680
			1	4,600

			1	4,500
			1	3,000
			1	6,500
	Total Sidi Bouzid		**14**	**40,750**
	Kasserine	Feriana	1	2,100
		Feriana	2	1,200
		Foussana	1	4,200
		Foussana	1	900
			1	2,100
		Hidra	2	1,800
		Majel Bel Abbes	2	2,100
		Telept	1	2,400
		Sbiba	2	3,000
	Total Kasserine		**13**	**19,800**
South-West	Gafsa	Gafsa	1	8,500
		El Ksour	1	5,300
		Metlaoui	1	6,500
		Sned	2	3,800
		Mdhila	1	1,800

	Total Gafsa		**6**	**25,900**
	Tozeur	Nefta	2	1,630
		Tozeur	2	12,500
		Tameghza	1	285
		Hamed Jerid	1	1,870
	Total Tozeur		**6**	**16,285**
	Kebili	Kebili	1	7,920
		Jemna	1	2,800
			3	8,447
		El Golâa	1	3,000
		Douz	1	13,000
	Total Kebili		**7**	**35,167**
South-East	Mednine	Djerba Houmet Souk	1	2,225
			1	2,605
		Zarzis	1	3,000
		Ben Guerdane	1	7,000
		Beni Khedache	1	450
		Djerba Ajim	1	6,500
	Total Medine		**6**	**21,780**

	Tataouine	Ghomrassen	1	2,985
		Remada	1	1,450
		Bir Lahmar	1	2,200
		Dhehiba	1	1,480
	Total Tataouine		**4**	**8,115**
	Gabes	Gabes	1	5,500
		Gabes	1	6,200
		Gabes	1	810
		Gabes	1	2,800
		Gabes	1	7,500
		Chenini Nahal	1	1,875
		El Metouia	1	3,000
		Ouedhref	1	2,000
		Ghanouch	1	3,400
		Mareht	1	4,300
	Total Gabes		**10**	**37,385**