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Report No. 71799-TN

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

FOR A

PROPOSED LOAN

IN THE AMOUNT OF EURO 387 MILLION
(US$500 MILLION EQUIVALENT)

TO THE

REPUBLIC OF TUNISIA

FOR A

GOVERNANCE, OPPORTUNITY AND JOBS DEVELOPMENT POLICY LOAN

October 26, 2012

Poverty Reduction and Economic Management Department
Maghreb Country Department
Middle East and North Africa Region

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TUNISIA - GOVERNMENT FISCAL YEAR

January, 1 – December, 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of September 30, 2012)

US$ 1.00	TND 1.573
US$ 1.00	Euro 0.774
Euro 1.00	TND 2.023

Weights and Measures

Metric System

ABBREVIATION AND ACRONYMS

AFD	French Agency for Development
AfDB	African Development Bank
ALMPs	Active Labor Market Programs
ANETI	Agence Nationale pour l'Emploi et le Travail Independent
ATI	Agence Tunisienne d'Internet / Tunisia Internet Authority
BCT	Banque Central de Tunisie / Central Bank of Tunisia
BH	Banque de l'Habitat
BNA	Banque Nationale Agricole
BOP	Balance of Payments
CAS/CPS	Country Assistance Strategy / Country Partnership Strategy
CBT	Central Bank of Tunisia
CFAA	Country Financial Accountability Assessment
CMF	Conseil du Marché Financier / Financial Market Authority
CNE	Comité National d'Evaluation / National Evaluation Committee
CNAM	Caisse Nationale d'Assurance Maladie / National Medical Insurance Fund
COSEM	Comité de Suivi et d'Enquête des Marchés / Public Procurement Monitoring Committee
CPAR	Country Procurement Assessment Review
CPR	Congrès pour la République / Congress for the Republic Party
CPI	Consumer Price Index
CSM	Commission Supérieure des Marchés / High Committee for Public Procurement
CSOs	Civil Society Organizations
DGRA	Department General for Administrative Reforms
DPL	Development Policy Lending
DSA	Debt Sustainability Analysis
DPR	Development Policy Review
EIA	Environmental Impact Assessment
EU	European Union
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
GNFS	Goods and nonfactor services
GO DPL	Governance and Opportunity Development Policy Loan
GOJ DPL	Governance, Opportunity and Jobs Development Policy Loan
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communications Technology
IDA	International Development Association
IFC	International Finance Corporation

IFIs	International Financial Institutions
IFRS	International Financial Reporting Standards
ILO	International Labor Organization
IMF	International Monetary Fund
INS	Institute Nationale de la Statistique / National Statistics Office
INT	Instance Nationale des Telecommunications / Telecoms regulator Authority
INTOSAI	International Organization of Supreme Audit Institutions
IP	Internet Protocol
IPO	Initial Public Offering
ISN	Interim Strategy Note
ISPs	Information Service Providers
JBIC	Japan Bank for International Cooperation
JICA	Japanese Development Agency
JSDF	Japan Social Development Fund
LDP	Letter of Development Policy
LFS	Labor Force Survey
M&E	Monitoring and Evaluation
MDGs	Millennium Development Goals
MENA	Middle East and North Africa
MHESR	Ministry of Higher Education and Scientific Research
MIC	Middle Income Country
MICI	Ministry of Investment and International Cooperation
MICS	Multiple Indicators Cluster Survey
MMR	Maternal Mortality Ratio
MOF	Ministry of Finance
MOH	Ministry of Health
MPDR	Ministry of Planning and Regional Development
MSME	Micro, Small and Medium Enterprises
MTEF	Medium-Term Expenditure Framework
MTFF	Medium-Term Financial Framework
NEF	National Employment Fund
NGOs	Non-Governmental Organization
NPLs	Non-Performing Loans
OECD/DAC	Organization for Economic Cooperation and Development/ Development Assistance Committee
PAFN	Programme d'Appui aux Familles Nécessiteuse / Support Program for Poor Families
PEFA	Public Expenditure and Financial Assessment
PEPE	Program for Schools with Education Priority
PER	Public Expenditure Review
PFM	Public Financial Management
PMR	Product Market Regulation
PPP	Public Private Partnership
PSD	Private Sector Development
RAMPs	Reserves and Assets Management Programs
ROSC	Report on the Observance of Standards and Codes
SAI	Supreme Audit Institution
SDR	Special Drawing Rights
SICAR	Societé d'Investissement à Capital Risque / Venture Capital Investment Company
SIVP	Stage d'Initiation à la Vie Professionnelle / Internship for Introduction to Professional Life
SME	Small- and Medium-Scale Enterprise
SNCFT	Société Nationale des Chemins de Fer Tunisiens
SOE	State Owned Enterprise
STB	Société Tunisienne de Banque
STEG	Société Tunisienne de l'Electricité et du Gaz

TA	Technical Assistance
TND	Tunisian Dinar
UGTT	Union Générale Tunisienne du Travail / Tunisia General Labour Union
UNDP	United Nations Development Program
UNICEF	United Nations International Children's Emergency Fund
USAID	United States Agency for International Development
UTICA	Union Tunisienne de l'Industrie, du Commerce et de l'Artisanat / Tunisia Business Confederation
VSL	Variable Spread Loan

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REPUBLIC OF TUNISIA

GOVERNANCE, OPPORTUNITY AND JOBS
DEVELOPMENT POLICY LOAN (DPL)

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LOAN AND PROGRAM SUMMARY

TUNISIA

GOVERNANCE, OPPORTUNITY AND JOBS DPL

Borrower	Republic of Tunisia
Implementing Agency	Ministry of Investment and International Cooperation
Financing Data	IBRD Loan; Amount: EURO 387 million, (US$500 million equivalent). Variable Spread Loan (VSL), repayment schedule linked to commitment with a thirty year maturity and 5 years of grace period, with tailored repayment of principal.
Operation Type	The proposed operation is the first in a programmatic series of two single-tranche operations. Each operation will be a single-tranche Development Policy Loan (DPL) to be disbursed upon effectiveness.
Main Policy Areas	The measures supported by this DPL focus on: (i) moving towards a level playing field, facilitating competition and private sector initiative; (ii) taking steps to assess and reinforce financial sector stability; (iii) introducing reforms to increase inclusion and to improve quality and strengthen accountability in social sectors; and (iv) improving transparency, accountability, and public participation in policy making.
Key Results Indicators	*Business environment:* - Reduction in costs of compliance with red-tape (direct costs and number of days) - Reduction in the price of international telecommunications (cents/min) *Financial Sector:* - Increase in minimum solvency ratio for banking system *Quality of health and education services* - Number of hospitals that have conducted and published results of evaluations of hospital services and have instituted improvement plans - Number of higher education programs and institutions evaluated and accredited *Transparency and accountability:* - Information on public finances is published online - Number of access to information requests granted
Program Development Objective(s) and Contribution to CPS	The objective of this DPL is to help Tunisia lay the policy foundations for a more competitive business environment, a strengthened financial sector, more inclusive and accountable social services, and more transparent public governance. The DPL is a core component of the World Bank's strategy to support the Tunisian Government in its task to consolidate social and economic change following the January 2011 revolution. The Bank's Interim Strategy Note for Tunisia was discussed at the Board in July 2012, and is designed to support Tunisia during this transition phase until a new government is elected under a new constitution.
Risks and Risk Mitigation	*(i) Risks related to renewed political instability from unmet or conflicting political aspirations:* The political climate may become more volatile in the run-up to the mid-2013 elections. This will impede the government's capacity to push through reforms. In addition, it is possible that the upcoming elections could bring a more fractious political leadership, less

	able or willing to carry through the reform agenda or sound macro policies. A benevolent international framework, including financial and political support from the international community, will help mitigate these political risks. *(ii) Risks related to the uncertainty of the economic outlook:* In addition to domestic social tensions, uncertainty about the economic outlook related to the impact of the Eurozone crisis and the stabilization process in Libya, as well as the pressure on the fiscal deficit and the Balance of Payments (BOP) resulting from the recent spike in international food and fuel prices, all pose significant risk to economic and political developments in Tunisia. Lower economic growth and additional pressure in the labor market could lead to renewed social tensions and reinforce a sense of lack of economic opportunity. A recurrence of instability might lead to a renewed loss of foreign investors' confidence, which will in turn affect industrial production and exports, further depressing domestic consumption and slowing economic recovery, and sending Tunisia into a negative spiral. To mitigate these risks, the authorities have adopted a supplemental budget to accelerate public investments, notably in lagging regions, scale up social interventions, and support enterprises during this transition. The Government is also exploring mechanisms to improve the targeting of food and fuel subsidies. The measures supported by this operation also aim to facilitate both public and private investments (through simplification of procurement procedures, and removal of red-tape), introduce reforms to progressively improve the quality and provision of social services, particularly in underserved regions, and to help reestablish social stability by consolidating the progress in giving greater voice and accountability to the population. *(iii) Risks to the stability of the financial sector:* The negative shock on the tourism sector (both from the revolution and the Libyan crisis) and the sensitivity of the exporting sectors to growth variations in Europe both translate into higher credit and liquidity risks in the banking sector. These risks will further aggravate the already relatively tight liquidity and weak asset quality of the banking sector. The measures supported by this operation aim to help reinforce the banking sector and reduce the risks of financial instability. *(iv) Risks related to the design and implementation of the program:* First, while the Constitutional Assembly Government has been elected in a general election and has full popular legitimacy, some key stakeholders may deem it inappropriate to address politically sensitive issues before a new government is elected under the new Constitution. Second, there is a risk that the next government could reverse the reform agenda, and/or adopt policies that may hinder long-term growth. All the above risks can be mitigated by consensus-building both within and outside of the current government. The Bank's technical assistance and informal discussions with civil society and key stakeholders during the preparation of the DPL should help mitigate these risks. For this reason, the Bank is working with the Government to have open debates on the various reforms and ensure there is broad consensus before reforms are adopted.
Operation ID	P128251

PROGRAM DOCUMENT

REPUBLIC OF TUNISIA

GOVERNANCE, OPPORTUNITY AND JOBS DEVELOPMENT POLICY LOAN

I. INTRODUCTION

1. **This Program Document proposes a Governance, Opportunity and Jobs Development Policy Loan (GOJ DPL) to Tunisia in the amount of Euro 387 million (US$500 million equivalent).** The proposed operation is the first in a programmatic series of two single-tranche operations to support Tunisia during the transition period, building on the progress made under the 2011 Governance and Opportunity (GO) DPL.[1] The proposed programmatic series supports the Constituent Assembly Government in its efforts to bring about social and economic changes to firm up the transition and prepare the ground for elections in mid 2013, under a new Constitution.[2] The DPL operations are a key component of the World Bank's support to Tunisia as outlined in the 2012 Interim Strategy Note (see Section IV).[3] The World Bank Group team responsible for this operation includes strong participation by the International Finance Corporation (IFC). The operation has also been prepared jointly with the African Development Bank (AfDB) and the European Union (EU), and in collaboration with the French Development Agency (AFD) and the United States Agency for International Development (USAID).

2. **With the election in October 2011 of a Constituent Assembly, and the formation of a new Government, Tunisia successfully completed the first phase of its political transition to a multi-party democracy.** 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 and economic era. The revolution was fueled by widespread anger and frustration over lack of social and political inclusion, governance and corruption problems, mounting unemployment and the rising cost of living. On October 23, 2011, ninety percent of the 4.1 million registered voters participated in the elections of a Constituent Assembly. Once the new Constitution is adopted by the Assembly, there will be a fresh round of elections (Annex 6). While the adoption of the new Constitution was initially planned for a year after the elections, a number of unsolved political and technical issues have delayed the process. As a result, national elections under the new Constitution are likely to take place between June and September 2013.

3. **Continued social unrest during most of 2011 and the crisis of confidence in the Eurozone negatively impacted economic performance in 2011, resulting in a steep increase in unemployment, and creating risks to the transition process.** The previous, Interim Government sought to mitigate the revolution's impact on the economy and to boost recovery using a combination of fiscal and monetary policy measures. In spite of the sound policy response, the combination of political uncertainty, social tensions and strikes, the European crisis and the Libyan crisis significantly

[1] This operation builds on the progress made by the Interim Government and supported by the 2011 Governance and Opportunity DPL which introduced a few measures to promote social peace and set the country on a renewed development trajectory. The aim of this follow up programmatic DPL series is to consolidate the gains made in governance, and to support the government to start tackling structural reforms to accelerate growth and job creation. A brief overview of progress in the implementation of the reforms introduced by the 2011 Governance and Opportunity DPL is provided in Annex 5.

[2] In this document, "Interim Government" refers to the government appointed immediately following the revolution in February 2011; and "Constituent Assembly Government" refers to the government named by the Constituent Assembly elected on October 23, 2011.

[3] The ISN was discussed by the Board of Executive Directors on 3 July, 2012. IBRD (2012). Interim Strategy Note for the Republic of Tunisia for the Period FY13-14. Report No. 67692 –TUN.

impaired economic activity. As a result, the economy contracted by 2 percent in 2011 and the unemployment rate increased from 13 percent to almost 19 percent.

4. **The most immediate challenge for Tunisia is to ensure economic and social stability, in a situation where the short term economic outlook remains uncertain.** Economic growth has started to recover in 2012 but the economic outlook remains uncertain and external financing needs are expected to remain large in the near term. Gross Domestic Product (GDP) growth is projected at 2-3 percent in 2012,[4] but the pace of recovery will depend on the Government's ability to manage the social and political tensions in Tunisia,[5] the execution and effects of the large fiscal stimulus, the impact of the increase in international food and fuel prices, and the extent to which the European recession will affect tourism, exports and Foreign Direct investment (FDI).

5. **In parallel, the Government needs to adopt structural reforms to accelerate medium-term economic growth and sustainable job creation.** In order to reduce unemployment, Tunisia needs to improve both the speed and the quality of its economic growth: it needs to enable a structural transformation of the economy from a low-wage, low value-added economy to a knowledge-based and skill-intensive economy.[6] It also needs to promote economic diversification in untapped sectors, such as information technology, manufacturing and health care, and align skills development to meet future labor market needs.

6. **An economic environment based on cronyism and rent seeking has been a key factor preventing higher growth and employment rates, and bold reforms are needed to move from a system based on privilege and connections to one based on competition and merit.** Adopting reforms to improve the business environment by removing red tape, reducing discretion and increasing transparency in the regulatory and legal framework for investments, eliminating privileges and removing monopolies/concessions to allow greater market contestability and competition, will send a strong signal to private investors that the rules of the game have changed and Tunisia is now open for business.

7. **More generally, the lack of transparency, social accountability and citizen participation in government affairs further exacerbated a sense of denied opportunity, leading to the January 2011 revolution.** The January 2011 revolution highlighted not only the lack of jobs and economic opportunity, but also the deep-rooted frustration of young Tunisians at their lack of voice in the management of public affairs. While the Interim Government immediately following the revolution adopted a number of governance measures to respond to the aspirations of Tunisians expressed in the revolution, these reforms need to be rapidly consolidated and expanded to translate into real progress towards the transparent and participatory management of public affairs.

The reforms supported by the proposed GOJ DPL operations focus on assisting Tunisia tackle these challenges, and thereby help to consolidate the transition and pave the way to accelerate inclusive growth and job creation in the medium-term. The reform program focuses on four key areas: (i) moving towards a level playing field, facilitating competition and private sector initiative; (ii) taking steps to assess and reinforce financial sector stability; (iii) introducing reforms to increase inclusion and to improve quality and strengthen accountability in social sectors; and (iv) improving transparency, accountability, and public participation in policy making.

[4] The Government's own GDP growth target for 2012 is higher at 3.5 percent,

[5] In addition, severe snowfalls and floods affected Tunisia in early 2012 posing an additional challenge to the government. Social strife increased in January 2012, but has since been at relatively moderate levels.

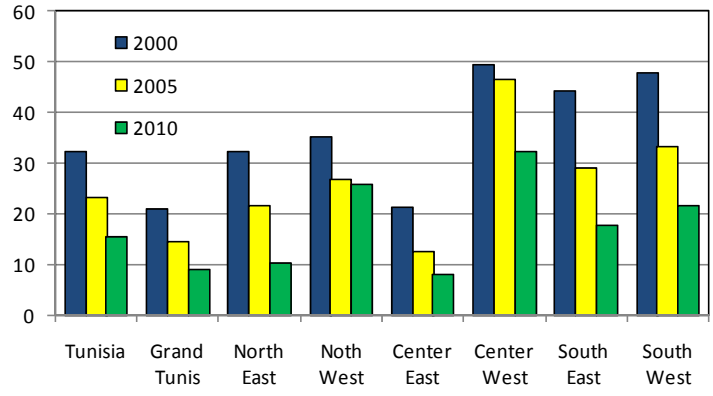
[6] World Bank (forthcoming 2013). *Development Policy Review: Creating jobs and accelerating inclusive growth*. The World Bank, Washington D.C.

II. COUNTRY CONTEXT

8. **Recent data indicate that poverty rates and inequality are higher than previously claimed.** Poverty rates were downplayed for many years while Tunisia maintained a very low poverty line, one sufficient only for survival and food consumption. In September 2012, the National Statistics Institute (*Institute Nationale de la Statistique*, *INS*) announced the revised poverty estimates for 2000 and 2005 and the new estimates for 2010. These estimates were calculated following a comprehensive review and update of the methodology for measuring poverty, in collaboration with the World Bank, the AfDB and local researchers.

9. **The new estimates highlight that poverty has decreased rapidly over the past decade, but regional disparities remain large.** While the new national poverty headcount is much higher than previously claimed, it is estimated to have decreased from 32.4 percent in 2000 to 23.3 percent in 2005 and to 15.5 percent in 2010. In a major break with the past, the INS also announced estimates of poverty broken down by region, which highlight that glaring regional disparities have persisted, with poverty estimates in 2010 ranging from a low rate of 8-9 percent in the Center East region and Grand Tunis to a high of 26 and 32 percent in the North West and Center West regions respectively (see Figure 1).[7]

Figure 1. Poverty Headcount in 2000, 2005 and 2010



Source: INS estimates presented in September 2012

10. **In fact Tunisia performs very well on most development indicators, although progress has been limited in remote regions.** Economic growth and public investments in human development have contributed to impressive indicators (Annex 7). At the national level, substantial progress has been achieved since 1990 to reduce infant and maternal mortality rates and child malnutrition, while the HIV/AIDS prevalence is very low. However there remains a need to improve indicators in rural areas, where children are more than twice as likely to be stunted (10 percent in rural areas versus 4 percent urban); fewer women get prenatal services or treatment for high-risk pregnancies, and maternal mortality rates are three times higher (70 versus 20 deaths per 100,000 live births, respectively); and only 50-60 percent of the population has access to safe drinking water and 40 percent to modern sanitation (compared to near universal access in urban areas).[8]

11. **High unemployment has emerged as the most urgent socio-economic issues for Tunisia to resolve, and is a major aspect of youth frustration that led to the January 2011 revolution.** While poverty decreased, the already large pool of unemployment continued to increase in recent years. Demographic trends resulted in a rapidly increasing number of youth entering the labor market, but economic growth has been inadequate to generate sufficient jobs to absorb new entrants, with unemployment remaining above 13 percent since the early 2000s, increasingly affecting the youth. In fact demographic trends suggest that unless the pace of economic growth accelerates substantially, unemployment will worsen over the next decade. With the economic downturn of the past year, the unemployment rate increased from 13 percent in 2010 to 18.9 percent in 2011 (or approximately

[7] Additional details on the poverty estimates are available online at the INS website: http://www.ins.nat.tn/communiques/Conference_presse_20_09_2012_NT.pdf

[8] Governance and Opportunity DPL, Program Document, Report 61627-TN, World Bank, 2011; Ministry of Public Health/UNICEF (2006), *Multiple Indicator Cluster Survey (MICS3)*, Tunisia.; UNICEF (2009), *State of the World's Children Report*, UNICEF, New York.

740,000 people). With economic recovery in the first half of 2012, it now appears to have stabilized and decreased to 17.6 percent.

12. **Extensive restrictions to economic activity in the domestic market have prevented greater investment and stifled job creation.** Unfortunately, the environment for the private sector in Tunisia has not allowed the sort of dynamism found in high-growth economies.[9] While macroeconomic policies were sound and a substantial package of incentives successfully attracted FDI, the economic environment under ex-President Ben Ali was characterized by lack of transparency, cronyism and related anti-competitive practices which discouraged entrepreneurship and private sector investment, particularly in the 'onshore' domestic economy.[10] The heavy and pervasive intervention by the State in the economy and slow progress in strengthening the business environment in the 'onshore' sector has plagued much of the private sector in Tunisia to date, limiting competition, private domestic investment (around 15 percent on average)[11], and job creation. Furthermore, irrespective of formal degrees, the Tunisian labor force often does not have the skills the private sector needs, and labor market institutions have proved ineffective in matching labor demand to supply.

13. **Unemployment is highest among educated young individuals, particularly women graduates**. While the national unemployment rate was 18.9 percent in 2011, it reached 27 percent among women and 35 percent among 15-29 year olds. In terms of skills levels, the majority of the unemployed are low-skilled workers, estimated at 66 percent of all unemployed in 2011. However, as efforts to expand tertiary education have not been matched by job opportunities, in recent years the increase in unemployment has mostly fallen on young and educated individuals, reflecting a growing imbalance between the demand for labor, tilted towards the unskilled, and an increasing supply of if not skilled at least educated labor.[12] As many as 35 percent of graduates were unemployed as of end-2011. Long-term unemployment is also rapidly increasing.[13]

14. **One of the reasons is that quality of education and learning outcomes remain low on average, and higher education needs to be more relevant and applicable to the economy.** Student learning outcomes are low, with fewer Tunisian students passing the 'Low International Baseline' for 8th grade math and 8th grade sciences than the international average (See Annex 7). Meanwhile, at the tertiary level, college graduates are confronted with a mismatch between the education and skills they obtain and the opportunities offered by the Tunisian job market. A study of 2004 graduates estimates that around 30 percent were in jobs that did not match the skills acquired through post-secondary education. Graduates from technical colleges do better in terms of finding and keeping jobs.

15. **With regard to gender, while Tunisia is one of the more advanced countries of the region and its positive record on the status of women needs to be carefully safeguarded, women's participation in the economy and government remain relatively low.** Women have benefited from Tunisia's high level of investment in education and made good progress in education (38 percent university enrollment compared to 25 percent of men, in 2007), wage parity, and reduced fertility rate (by nearly half). However despite the fact that women have access to education and indeed make up the majority of higher education graduates, they are less likely to be employed. As many as 48 percent of women graduates were unemployed, compared to 31 percent for men as of end-2011. As far as

[9] World Bank (2009), *MENA: Private Sector from Privileges to Competition*, The World Bank, Washington D.C.

[10] A detailed description of the governance failures crippling the business environment in Tunisia is provided in the Program Document of the 2011 Governance and Opportunity DPL: World Bank (2011). *Program Document: Governance and Opportunity DPL*. June 2011. Report N.61627-TN.
http://documents.worldbank.org/curated/en/2011/05/14427346/tunisia-governance-opportunity-development-policy-loan-program

[11] As a result, domestic private investment remained low and increasingly focused on real estate, considered safer.

[12] World Bank (2010). *Development Policy Review: Towards Innovation Driven Growth*. Report No. 50847-TN. The World Bank, Washington D.C.

[13] In 2010, about 34 percent of the unemployed had been searching for employment for longer than 12 months, with rates of long-term unemployment particularly high among university graduates (44 percent). Moreover, the labor market situation has also been deteriorating with respect to quality of employment, with over 70 percent of youth aged 15 to 24 working without a contract in 2010.

participation in politics, only 58 of the current 217 member constituent assembly members are women (i.e. 27 percent), most of which have assumed an informal oversight function to ensure that women's rights are not jeopardized.

16. **Gender is currently a hotly debated issue in Tunisia, with various political parties having different views on the appropriate role of women in society and the economy.** The Government has made pronouncements reiterating that the status of women will be safeguarded. However the role of women in socio-economic life continues to be a topic of much debate in Tunisia, including in the preparation of the draft Constitution. The Bank has emphasized the positive impact of women's equal opportunities to participate in the economy and society for accelerating economic and social development and reducing poverty, and will continue to engage the Government to further promote the status of women.

17. **Lack of adequate participation, transparency and accountability was a key trigger of the revolution.** A prevailing culture of secrecy also prevented informed debates or consultations on public policies, finances or services. One of the words most frequently heard from young people demonstrating in Tunisia was the word "dignity". This highlighted that social and economic exclusion went beyond the narrow dimension of material poverty, whether conceived in terms of income or the fulfillment of basic needs. It was first and foremost about exclusion, lack of access to opportunities and participation. Achieving greater government accountability to citizens and greater citizen participation and feedback in policy-making will require greater transparency in government operations and higher standards for public officials.

18. **More generally, Tunisia performed poorly across most dimensions of governance and anti-corruption.** Global Integrity and Freedom House rankings rate Tunisia as 'very weak' or 'not free' in most dimensions of governance.[14] Most notably, Tunisia had important shortcomings and failures related to lack of voice and accountability, a highly centralized decision-making process which undermined the system of checks and balances (which largely existed on paper only), and more generally substantial discretion in the application of the laws.

19. **As a case in point, Tunisia's banking sector was for long time afflicted by governance problems, resulting in weak performance, and this situation has been further aggravated by the economic downturn**. Political interference and weak governance in the financial sector had severely undermined its performance and led to a high number of non-performing loans. Following the revolution, banks were hit by the sharp downturn in the tourism sector, which constituted a substantial portion of the non-performing loans and which saw a drop in revenues of 33 percent in 2011. Liquidity issues became more pressing, prompting the Central Bank to extend very large credit facilities to banks.

20. **Following the Revolution, the Interim Government in 2011 initiated a broad program of emblematic reforms to strengthen governance and social accountability.** Notably the government revised the law on Freedom of Association to remove all major legal obstacles and facilitate the development of a strong and free civil society; revised the legal framework to allow public access to information and give the public the right to access information held by public bodies (and among other things, remove constraints to public access to economic and social statistics, including micro data); removed restrictions to access to the Internet and modified the Domain Names Charter for the hosting of Internet websites, in order to simplify the procedures for the registration and hosting of Internet websites; revised the legal framework for public procurement to improve the efficiency and transparency of procurement procedures and to shorten the decision process without compromising quality; launched a systemic, participatory, measurable and visible reform to simplify administrative

[14] A detailed description of the governance rankings for Tunisia is provided in the Program Document of the 2011 Governance and Opportunity DPL: World Bank (2011). *Program Document: Governance and Opportunity DPL*. June 2011. Report N.61627-TN.
http://documents.worldbank.org/curated/en/2011/05/14427346/tunisia-governance-opportunity-development-policy-loan-program

procedures and red-tape and reduce discretion and arbitrariness in taxes and customs procedures; established a new regulatory framework for the National Employment Fund, starting with moving its management away from the Presidency to the Ministry of Employment; revised the regulatory framework on banks' corporate governance practices, including the introduction of criteria for selection of senior management and members of the board; and enabled the use of participatory monitoring and evaluation mechanisms that allow citizens to rate performance of social programs and public services (e.g., community scorecards).

21. **The Interim Government also established an independent governance commission to investigate corruption and embezzlement allegations against the Ben Ali regime**.[15] The commission's report released in November 2011 concluded that corruption was widespread across all state agencies, ministries, banks and the media, and pervaded the administration, legal system, properties, state projects and contract awards, privatization, telecommunications and the tax system. The commission made recommendations to strengthen the legal and institutional framework on anti-corruption. The Government subsequently signed into law a decree foreseeing a permanent anti-corruption framework, which will help pave the way for building stronger institutions to effectively prevent and fight against corruption, while not deterring 'clean' private investors.

22. **Tunisia successfully completed the first phase of its political transition to a multi-party democracy.** On October 23, 2011, ninety percent of the 4.1 million registered voters participated in the elections which were declared free and fair by international observers.[16] Ennahda, the once-banned moderate Islamist Party, won the most seats (89 seats, or 37 percent) in the 217-member Constituent Assembly, making it the leading governing party. It formed a coalition government with two secular political parties, the Congress for the Republic (*Congres Pour la République, CPR*) with 9 percent, and Ettakatol, the social democratic party, with 7 percent. The new cabinet, which includes members from Ennahda, CPR, Ettakatol, and independent ministers, was confirmed on December 23, 2011 by the Constituent Assembly.

23. **The Ennahda-led coalition Government is actively working with international partners.** Demonstrating its commitment to strengthening its participation in the global economy and its intentions to work with many international partners, the Government has maintained good relations with the European union (EU), Gulf countries, the United States of America (USA), and international financial institutions such as the World Bank Group, the African Development Bank, the Islamic Development Bank and the International Monetary Fund (IMF), and is pursuing broader links with partners from other Maghreb countries, Asia, Africa and South America.

RECENT ECONOMIC DEVELOPMENTS[17]

24. **In spite of the sound policy response, the economy contracted (-2 percent) in 2011, as a result of the ongoing social tensions in the country, the Eurozone crisis and the war in Libya, and unemployment increased.** Domestic demand contracted by -1 percent, due mainly to a significant drop in investment (-13 percent). Proactive fiscal and monetary policies induced by the authorities succeeded nevertheless in keeping consumption growth (+5 percent) at a similar level to that of 2010. As a result of the weak economic performance and the return of a large numbers of Tunisians from Libya, the unemployment rate jumped from 13 percent in 2010 to approximately 19 percent by end-2011. However it appears to have stabilized and decreased to 17.6 percent as of June 2012.

25. **While the social turmoil associated with the revolution affected selected sectors of the economy, the economic slowdown in Europe has had a broader impact.** The tourism sector was

[15] The Stolen Asset Recovery Initiative (StAR), sponsored jointly by the World Bank and the United Nations (UN), has been supporting the efforts of Tunisian authorities in recovering stolen funds and assets.
[16] However, the independent electoral commission invalidated votes cast for 7 seats of the Aridha Chaabia party, on the grounds that they had exceeded campaign spending limits (they retained 19 of 26 seats).
[17] See Annex 8 for additional details.

particularly affected and revenues contracted by 33 percent in 2011.[18] Similarly the mining sector (mostly phosphate) was severely affected by social tensions and strikes for most of 2011, which led to a 30 percent decline of its exports (in real terms). Most industrial production declined during the first quarter due to the political change and social tensions. However most of the key exporting sectors recovered from the second quarter, driven in particular by the mechanical and electrical industrial production, which grew by 4 percent in 2011 (in real terms), while the textile industry stagnated (-0.9 percent in real terms). On the other hand, thanks to a good rainy season, agricultural production grew by over 9 percent in 2011 (in real terms), which partially compensated poor performance in other sectors. FDI already low from the 2008 global financial crisis dropped by a further 29 percent (in real terms).

26. **The Interim Government sought to mitigate the revolution's impact on the economy in 2011 and to boost recovery using a combination of fiscal and monetary policy measures, with mixed success**. The authorities' macroeconomic response was appropriate, if only partially effective. On the fiscal side, the Interim Government put in place a countercyclical policy with a large fiscal stimulus. They approved a supplemental budget in June 2011 which introduced additional spending of approximately 5 percent of GDP in measures to stimulate the economy, increase social assistance and provide resources to lagging regions where the need for jobs and basic services is greatest. However, only part of these resources could be absorbed within the year due to delays in the execution of public investment projects resulting from social strife, administrative challenges, and weak implementation capacity at the local level. As a result, the 2011 fiscal deficit which was expected to increase from 2.5 percent of GDP in the original budget to 4.8 percent, reached only 3.5 percent of GDP in 2011. In parallel, the Central Bank eased monetary policy significantly to stimulate the economy. The Central Bank reduced reserve requirements in 2011 from 10.5 percent to 2 percent (in three steps) while providing a substantial amount of short-term loans to banks to increase their liquidity and encourage lending to businesses. It also reduced its main interest rate from 4.5 percent to 3.5 percent in two steps in June and September 2011 to boost access to credit and investment. In spite of the economic downturn, broad money M3 and lending to the economy grew by 8 percent and 13 percent in 2011, respectively.[19]

27. **Despite the weak international environment, the economy has started to recover in 2012.** Preliminary data indicate that the economy grew by 3.3 percent during the first six months of the year, but economic recovery is being hampered by the Eurozone crisis. GDP growth was slower during the second quarter (at 2.1 percent) compared to the first quarter (at 4.6 percent). Favorable weather resulted in a good agricultural season, and the tourism sector revenues increased by 35 percent during the first eight months of 2012 compared to the same period in 2011 (thus reaching 90 percent of the 2010 level). Economic growth was also driven by a recovery in FDI which increased by 48 percent during the first five months of the year compared to 2011. However, the industrial sector is being negatively affected by the Eurozone crisis, as the EU market absorbs almost 80 percent of Tunisian exports. Production in the textile industry and the electric and mechanical industry declined by 8.6 percent and 8.2 percent, respectively, in the second quarter 2012. As a result of the fiscal stimulus (see paragraph 36 below), administration services continued to grow at 6.7 percent during the first semester of 2012. As indicated above, unemployment decreased somewhat in early 2012, which is also reflected in an increase of approximately 8 percent of registered job vacancies during the first 6 months of 2012 (at 54,360 vacancies) compared to 2011.

28. **Alongside the recovery, consumer prices have increased since the last quarter of 2011, led mainly by food and other consumption prices.** In part, this is related to the large liquidity injection by the Central Bank to boost domestic demand. Hence, while average inflation was approximately 4 percent in 2011, inflationary pressures have increased since the last quarter of 2011 and year-to-year inflation reached 5.7 percent in February 2012, and appears to have stabilized since

[18] Tourism receipts and tourist arrivals fell by 33 percent and by 31 percent, respectively in 2011 compared to 2010

[19] This compares with 12 percent and 20 percent respectively in 2010, at a time when the Central Bank had to mop up liquidity

then reaching 5.6 percent in July (and 7.6 percent excluding food prices, which are mostly regulated). The recent drop in international commodity prices, continued low external demand from the Eurozone, as well as the good agricultural season should help keep inflation at moderate levels.

29. **The current account deficit widened considerably in 2011, reaching 7.3 percent of GDP against 4.8 percent in 2010,** due mainly to the sharp drop in tourism receipts, while the trade balance remained stable, with almost zero growth in exports (in real terms) and a moderate contraction in imports. These trends resulted in a 20 percent reduction in international reserves, from approx US$9.5 billion at end-2010 (or 4.7 months of imports) to approx US$7.5 billion at end of 2011 (or 3.5 months of imports). The current account deficit remained large in the first half of 2012 as the improvement in tourism receipts has been offset by a rapid increase in imports (by 10.6 percent at constant prices), while exports have remained stagnant (at -1.4 percent at constant prices) suffering from the slowdown in Europe.

Table 1: Tunisia: Selected Macroeconomic Indicators, 2009-2014

	2009 Act.	2010 Act.	2011 Act.	2012 Est.	2013 Proj.	2014 Proj.
National income and prices						
Real GDP growth rate (%)	3.1	3.1	-2.0	3.5	4.5	5.2
Nominal GDP (TND million)	58883	63522	65370	71319	78309	86356
Nominal GDP per capita (in U.S. dollars)	4180	4212	4350	4188	4496	4972
GDP inflation (%, period average)	3.7	4.7	4.0	5.4	5.0	4.8
Central government (percent of GDP)						
Total revenues and grants[1]	23.4	23.3	24.8	26.1	24.6	23.4
Total expenditure and net lending	23.3	26.1	28.0	31.8	30.0	28.3
Current expenditure	17.9	17.6	20.9	23.9	22.8	21.2
Capital expenditure	6.8	6.8	7.2	7.7	7.0	6.9
Overall balance before grants and privatization[1]	-3.0	-1.1	-3.5	-6.6	-5.9	-5.3
Money and credit						
Broad money (M2)/GDP	61.8	64.5	67.7	68.8	70.2	72.1
Broad money (M2, 12 months % change)	13.0	11.9	9.4	11.0	12.0	13.3
Credit to the economy (percent change)	9.9	18.4	13.5	7.2		
Interest rate (money market rate, in percent, e.o.p)	4.1	4.1	3.1			
Investment and savings						
Gross national savings (excluding grants)/GDP	21.6	20.8	15.9	15.2	16.5	17.5
Gross domestic investment/GDP	24.1	24.5	21.5	23.5	23.8	23.9
External sector						
Current account balance/GDP (excluding grants)	-2.8	-4.8	-7.3	-7.4	-6.8	-6.0
Gross international reserves (USD billion)	11.1	9.5	7.5	7.1	7.7	9.4
In months of GNFS imports	6.3	4.7	3.5	3.5	3.5	3.8
Exchange rate (TND per USD, period average)	1.35	1.43	1.41			
Debt stock						
Public debt (as percent of GDP)	42.8	40.4	44.0	46.1	47.3	48.0
Domestic debt	17.7	15.9	18.5	17.9	17.8	16.8

Sources: Tunisian Authorities and World Bank staff

Notes: 1. Includes the proceeds from the sale of confiscated assetts

30. **The Central Bank used up significant reserves to support the Tunisian Dinar and manage an orderly depreciation of the exchange rate since 2011**. It sold approximately US$2 billion in 2011 and has continued intervening in the market to smooth the depreciation of the Tunisian Dinar in 2012. The real effective exchange rate thus remained relatively stable and broadly in line with fundamentals, with a 2 percent nominal depreciation during January to August 2012 against the Euro, offsetting the inflation differential with the Eurozone. The Tunisian Dinar also depreciated by 6.4 percent against the US Dollar during the same period. In order to progressively shift from a tightly

managed exchange rate to a more flexible exchange rate, the Central Bank changed its exchange rate policy framework in April 2012.[20] This should help preserve the Central Bank's foreign reserves and support liquidity availability in the financial sector.

MACROECONOMIC OUTLOOK[21]

Growth and Employment

31. **Following the weak performance in 2011, growth is expected to gradually recover in 2012 and accelerate after the 2013 elections.** While the economy has started to recover in 2012, the overall the economic situation is likely to remain difficult, and the Government expects real GDP to grow by approximately 3.5 percent in 2012 (Table 1).[22] To be sure, these projections are subject to substantial uncertainty as the pace of recovery will depend on the Government's ability to manage the social and political tensions, the extent of the European recession, the execution of the fiscal stimulus and the movement in international food and fuel prices. The baseline rate of 3.5 percent in 2012 is based on somewhat optimistic but plausible assumptions of a full recovery in the mining sector, moderate growth in most manufacturing sectors (except textiles), a 30 percent increase in tourism revenues (to 90 percent of the 2010 levels), a 25 percent increase in FDI (to the 2010 level), and the full implementation of the stimulus package of approximately 5 percent of GDP (compared to 2010) adopted by the current Government.

32. **The medium-term growth outlook remains positive.** The Government expects the pace of growth to increase to approximately 4.5 percent in 2013 and 5.2 percent in 2014 as a result of the combined effect of the recovery in exports, tourism and FDI, the continuation of major public investments, and the package of reforms adopted by the Interim Government which is expected to lead to growing investment. Notably, domestic private investment is expected to expand in 2013 and beyond, as a result of the expected completion of the political transition by mid-2013, and the structural reforms supported by this DPL program.[23] The Tunisian recovery could consolidate in 2014, as improved confidence domestically as well a recovery in the EU and in Libya will contribute to raise GDP growth to around 5 percent.[24]

33. **Unemployment is expected to remain high in the short-term.** Given demographic trends and the historical employment-growth elasticity, growth rates of approximately 4.5 percent are required to reduce the stock of unemployment in Tunisia. The difficult short-term economic outlook therefore is expected to result in the unemployment rate to remain at approximately 17-18 percent in 2013-2014. Beyond 2014, assuming an economic growth of 5 percent, the level of unemployment will start decreasing gradually to reach approximately 15 percent by 2017. A rapid recovery in Libya could accelerate the reduction in unemployment.

[20] The Central Bank computed its reference exchange rate based on the average exchange rate on the interbank market instead of a fixed currency basket, and it intervened in the foreign exchange market through bilateral transactions when market quotations deviated substantially from the fixing rate of the day.

[21] The medium-term macroeconomic framework presented here is based on the 2012-2017 macroeconomic framework provided by the Tunisian authorities. The Bank has also prepared a more prudent scenario with lower growth rate and more gradual improvement in the primary deficits, compared to the Government projections (see Annex 8).

[22] Projected GDP growth has been revised downward from 4.5 percent in the original 2012 budget. However growth may well be even lower, at 2-3 percent in 2012 (see Annex 8).

[23] The growth target for 2013 is based on the optimistic assumption of another good year for agriculture (+4 percent annual growth); a rapid increase in manufacturing output (+4 percent growth); a strong recovery in exports; a further recovery in tourism (+15 percent, to reach pre-2011 levels); and a return of investors' confidence is expected to result in a rapid increase in FDI back to pre-financial crisis levels (at nearly 5 percent of GDP).

[24] For 2014 the Government assumes the return to normal business activity, which combined with an increase in external demand is expected to contribute to a further recovery in exports and tourism beyond pre-revolution levels, and a further increase of 20 percent in FDI.

Fiscal Policy

34. **Fiscal policy will play a critical role in the next one to two years of the transition.** In 2011 the authorities anticipated the widening of the fiscal deficit to be temporary, and expected the fiscal deficit to decrease in 2012 (to 4.1 percent) and 2013 (to 2.7 percent) from expenditures control and increased tax revenues. However, the deteriorating external and internal economic situation (itself partially due to the low budget execution in 2011) has led the Government to revise its policy and adopt a larger fiscal stimulus in 2012.

Table 2: Tunisia Fiscal Framework 2009-2014

	2009 Act.	2010 Act.	2011 Est.	2012 Proj.	2013 Proj.	2014 Proj.
	(Percent of GDP)					
Total revenues and grants	23.4	23.3	24.8	26.1	24.6	23.4
Revenue[1]	23.1	23.2	24.5	25.3	24.0	23.1
Of which: Tax revenues	19.8	20.0	20.9	21.3	21.3	21.3
Total expenditure and net lending	23.3	26.1	28.0	31.8	30.0	28.3
Current expenditure	17.9	17.6	20.9	23.9	22.8	21.2
Total transfers and subsides	3.8	3.7	6.0	8.0	6.9	5.9
Wages and salaries	10.7	10.7	11.7	12.4	12.5	12.4
Interest payments	2.0	1.8	1.8	1.8	1.7	1.6
Capital expenditure	6.8	6.8	7.2	7.7	7.0	6.9
Domestic primary balance	-1.0	0.5	-1.7	-4.8	-4.2	-3.6
Overall balance (excluding grants and privatization)[1]	-3.0	-1.1	-3.5	-6.6	-5.9	-5.3
Total financing	3.0	1.1	3.5	6.6	5.9	5.3
External (net)	0.0	-0.4	0.6	3.2	4.0	4.5
Domestic (net)	2.7	1.3	2.0	0.8	1.1	0.4
Memorandum items:						
Total external debt	49.8	48.7	48.1	50.7	49.1	47.1
Public debt (as percent of GDP)	42.8	40.4	44.0	46.1	47.3	48.0
Domestic debt	17.7	15.9	18.5	17.9	17.8	16.8
External debt	25.1	24.5	25.5	28.2	29.5	30.9

Sources: Tunisian Authorities and World Bank staff

Notes: 1. Includes the proceeds from the sale of confiscated assetts for 2012-2014

35. **The authorities have approved an expansionary budget in 2012 but its execution remains a challenge.** The 2012 Supplementary Budget Law, adopted in May by the Constituent Assembly, envisages a large fiscal stimulus with a 22 percent increase in public expenditures and a fiscal deficit of 6.6 percent of GDP in 2012. Current expenditures were increased by 17 percent (compared to 2011, or an additional 2 percent of GDP), including large increases in the wage bill (+13 percent) and subsidy transfers (+12 percent) which now account for 53 percent and 28 percent of the planned current expenditures, respectively. The supplementary budget also includes an ambitious 30 percent increase in public investment spending compared to 2011 (or an additional 1.7 percent of GDP). Total tax revenues are assumed to remain constant (as a share of GDP), while non tax revenues are expected to be higher by approximately 2 percent of GDP (related to the sale of assets confiscated from the family of former president Ben Ali).[25] The additional expenditures are also to be financed by domestic borrowing, external financing (a similar amount in budget support as in 2011, and additional borrowing from Qatar and from capital markets with a US Government guarantee), and exceptional

[25] The projected fiscal deficit of 6.6 percent in 2012 accounts for approximately 2 percent of GDP in non-tax revenues originating from the sale of assets confiscated to former President Ben Ali and his family. These assets include shares in the capital of 114 firms, notably a 25 percent stake in the largest mobile telecom operator (*Tunisiana*). The Government plans to raise TND 1.2 billion (approximately 2 percent of GDP) from the sale of some of these assets in 2012, but in fact the process is likely to take longer. A further 1.5 percent of GDP from the sale of confiscated assets is expected in 2013 and 0.7 percent of GDP in 2014.

financing, including using a part of the savings from the 2006 *Tunisie Telecom* privatization, and new privatization receipts (notably a new 3G license sold to *Tunisiana* in May).

36. **The authorities envisage a less expansionary fiscal policy in 2013 and 2014.** The fiscal deficit is expected to decrease to 5.9 and 5.3 percent of GDP, respectively in 2013 and 2014, driven by a reduction in the subsidy bill which is expected to decrease back to 6 percent of GDP by 2014, a stable wage bill (at approximately 12.5 percent of GDP), and more realistic expectations about execution capacity of public investment projects in line with historical performance (at approximately 7 percent of GDP). The deficit is expected to be financed mainly by external borrowing, with public debt peaking at approximately 48 percent of GDP in 2014, and decreasing thereafter.[26] These projections are based on fairly optimistic assumptions about GDP growth, however, and also may not take fully into account the ultimate recapitalization needs of public banks.[27] The projections also depend critically on the movements in the international food and fuel prices and the exchange rate, as well as in the Government's ability to control the wage and pension bill. In this context the Government is exploring possible options to reform the food and fuel subsidies towards more targeted social transfers and also a reform of the pensions system, with technical assistance by the Bank.

Monetary Policy and Inflation

37. **The authorities will have little room for additional monetary expansion in 2012 and will be limited by the rise of inflationary pressures**. While average inflation decreased to approximately 4 percent in 2011 (from 4.7 percent in 2010), inflationary pressures have increased since the last quarter of 2011. The year-on-year inflation (CPI) increased to 5.6 percent in July 2012, against 3.4 percent a year earlier, driven mainly by food prices which grew by 7.5 percent compared to non-food prices which increased by 4.6 percent. Inflation is expected to average at approximately 5.4 percent in 2012 and to decrease to approximately 5 percent in 2013 and 2014. Inflationary pressures have arisen as a result of the international increase in commodity prices since mid-2011, and the large monetary easing by the Central Bank in 2011 to boost domestic demand. The impact of the increases in the international fuel and food prices were further exacerbated by the depreciation of the Tunisian Dinar.[28] To keep control of inflation the Central Bank increased the main interest rate by 25 basis points in September 2012 and signaled that further increases are possible if inflationary pressures persist.

38. **Tunisia's banking sector, already weak prior to the revolution, was further hit by the economic downturn.**[29] In response, the Central Bank issued a circular in April 2011 encouraging the banks to reschedule their loans to distressed companies, as part of the economic stimulus measures. This measure temporarily allowed the banks to avoid a rapid downgrading of their solvency ratio and revenues. In addition, the Central Bank provided liquidity support to banks in 2011 which allowed credit growth to continue at 13.5 percent in 2011 (and prevented bankruptcies) and then at an estimated 6.3 percent during the first seven months of 2012. As a result, the level of nonperforming loans (NPLs) appeared to remain relatively stable in 2011, but in fact is likely to have increased if one classifies as non-performing at least some of the loans which were rescheduled in the context of the April 2011 Circular. Nevertheless, with less room for monetary easing in 2012, there is a risk that the

[26] While not shown in the tables, the Government has prepared a Medium Term Fiscal Framework to monitor fiscal sustainability. The Bank has also carried out a Fiscal and Debt Sustainability Analysis and the results are presented below (and in Annex 9).

[27] As part of the reforms supported by this DPL, the Government has launched an international tender to carry out detailed strategic and financial audits of three public banks, and the results of the audits are expected in mid-2013. The Government has indicated it will prepare a restructuring and recapitalization plan for the three banks based on the results of the audits.

[28] Although the pass-through of international food and energy prices to domestic consumer prices is controlled as domestic prices are administered, the rising fiscal cost of the subsidies forced the Government to raise fuel price in early September 2012. An increase in subsidized food items is also expected.

[29] At the request of the Governor of the Central Bank, in April 2011 the Bank and the IMF carried out full-fledged stress tests by bank. In January 2012, the Bank and the Fund also conducted a joint FSAP (Financial Sector Assessment Program) assessment and are now discussing with the authorities the implementation of its findings. Notably, banking sector recapitalization needs were estimated at approximately 3 percent of GDP, and 5 percent of GDP in an adverse scenario.

banking system will start to tighten credit, making it difficult for businesses to operate and dampening the economic recovery.

Balance of Payments

39. **The current account deficit is projected to remain at 7.4 percent of GDP in 2012 (compared to 7.3 percent of GDP in 2011),** and perhaps even higher, as Tunisian exports are increasingly being affected by the euro crisis. Preliminary data for the first half of 2012 indicates a contraction in exports of goods by 1.4 percent (in real terms),[30] while imports are growing rapidly by 10.6 percent (in real terms) as of end-June 2012. While most of sectors are showing signs of recovery in exports and imports, the offshore sector (exporting industries) has been strongly affected by the Eurozone crisis. The tourism sector that was severely affected by the political instability during 2011 started recovering since early 2012. During the first eight months of 2012, tourism arrivals increased by 48 percent and tourism receipts increased by 35 percent (to reach approximately 90 percent of the 2010 level). The specialization as a low cost destination could be an advantage to regain competitiveness on the depressed European market. Despite the Eurozone crisis, FDI inflows increased by 45 percent (in nominal terms) during the first six months of 2012 compared to the same period of 2011 (and by 8.3 percent compared to 2010). While the energy sector continues to attract the dominant share, FDI in manufacturing industries also grew by 18.5 percent.

[30] The European economic slowdown is expected to continue affecting Tunisian manufacturing export sector over 2012-2013, as the EU market represents about 75 percent of the Tunisian export. Energy and phosphate exports are expected to recover, driven by relatively high international prices and assuming that production will be less affected by disruptive activities than during 2011.

Table 3: Tunisia Balance of Payments 2009-2014

	2009 Act.	2010 Act.	2011 Est.	2012 Proj.	2013 Proj.	2014 Proj.
			(USD millions)			
Current account balance (excluding grants)	-1,234	-2,104	-3,371	-3,360	-3,328	-3,270
Trade balance	-3,701	-4,575	-4,799	-5,086	-5,727	-6,579
Exports, f.o.b. (millions of U.S. dollars)	14,418	16,431	17,822	16,368	17,700	19,760
Imports, f.o.b. (millions of U.S. dollars)	18,119	21,005	22,621	21,454	23,427	26,339
Services and income balance	282	204	130	513	812	1,349
Net transfers	2,183	2,267	1,298	1,214	1,592	1,968
Capital and financial balance	2,866	1,913	1,770	2,930	3,962	4,945
Capital account	164	82	155	387	265	203
Financial account	2,702	1,831	1,616	2,543	3,696	4,742
Direct foreign investment (net)	1,437	1,309	461	1,519	1,875	2,532
Medium- and long-term loans (net)	339	145	408	573	1,123	1,751
Disbursement	2,019	1,845	2,348	2,648	2,911	3,131
Amortization (-)	-1,679	-1,700	-1,940	-2,075	-1,788	-1,380
Short-term/other capital flows	926	377	747	451	698	441
Overall balance	1,632	-191	-1,601	-430	634	1,676
Changes in reserves	1,673	-190	-1,601	-430	634	1,676
Memorandum items:						
Current account balance/GDP (including grants)	-2.8	-4.8	-7.3	-7.4	-6.8	-6.0
Current account balance/GDP (excluding grants)	-3.2	-4.9	-7.6	-8.3	-7.3	-6.3
Gross international reserves (USD billion)	11.1	9.5	7.5	7.1	7.7	9.4
In months of imports of GNFS[1]	6.3	4.7	3.5	3.5	3.5	3.8
Exchange rate (TND per USD, period average)	1.35	1.43	1.41			

Sources: Tunisian Authorities and World Bank staff
Notes: 1. End-of-year reserves over current year imports.

40. **The current account deficit is expected to begin to decrease only gradually during the next few years.** In 2013, the Government envisages exports to grow by 6.1 percent, which could be outpaced by the increase in imports by 6.6 percent, as the recovery in exports tends to be preceded by growing imports in the same sector (inputs and equipment imports), keeping the current account deficit at around 7 percent in 2013. Exports and tourism will be boosted by the European recovery in 2014, leading to a reduction in the current account deficit to approximately 6 percent of GDP. The high level of current account deficits is expected to be mitigated by a rapid recovery of FDI (reaching pre-financial crisis levels of 5 percent of GDP by 2014), capital inflows (also related to privatization and selling of assets in 2012-2013), and support from the international community.

41. **Nevertheless, the overall financial situation should remain manageable**, thanks partly to the support from international community. External financing needs are expected to remain large in 2012 and 2013 and to decrease gradually over subsequent years. External financing needs for 2012 were always going to be fairly large due to the scheduled repayment of a large debt maturity,[31] and have increased further as a result of the deteriorating economic performance in the EU. They are now estimated at approximately US$5.4 billion (compared to US$5.3 billion in 2011) (Table 4). External financing requirements are expected to decrease to US$5.1 billion in 2013 and US$4.6 billion in 2014.

[31] A large government-issued Euro-bond of €650 million which has been effected in April 2012.

Table 4: External Financing Needs 2006-2014 (in US$ millions)

	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Act.	Act.	Act.	Act.	Act.	Est.	Proj.	Proj.	Proj.
Current account deficit	619	917	1712	1234	2105	3371	3360	3328	3269
External medium and long term debt amortization[1]	1653	1570	1167	1347	1642	1940	2075	1788	1380
Total requirements	**2272**	**2487**	**2878**	**2581**	**3747**	**5311**	**5435**	**5116**	**4649**
Grants	145	166	79	165	82	155	387	265	203
FDI and portfolio investments[2]	3305	1515	2595	1525	1334	461	1519	1875	2532
Public borrowing	1453	1615	1079	1549	1728	2348	2648	2911	3131
Of which:									
Official creditors	963	1103	831	1315	1516	2142	1672	1601	1546
Private (incl bonds)	320	324	77	54	37	206	976	1310	1585
Other capital flows n.i.e. (includes short term lending)	97	156	646	926	377	747	451	698	460
Total resources	**5000**	**3453**	**4399**	**4164**	**3521**	**3710**	**5005**	**5749**	**6325**
Change in forex reserves	-2138	-723	-1567	-1673	190	-1601	-430	634	1676
Total financing	**2862**	**2730**	**2832**	**2491**	**3712**	**5311**	**5435**	**5116**	**4649**

Sources: Tunisian Authorities and World Bank staff

Notes: 1. The privatization of Tunisia Telecom in 2006 led to an exceptional capital inflow of approx US$2.3 billion.

2. A foreign disinvestment in the Tunisiana cellphone operator in 2011 led to an exceptional capital outflow of US$600 million.

42. **Over the medium term, the authorities expect to return to capital markets for an increasing share of their financing needs.** The authorities intend to continue to rely mainly on external official financing in 2012 and 2013, and to begin to return to the markets with the benefit of guarantees. Until the global financial crisis Tunisia was borrowing significantly from international capital market for its financing needs, and the International Financial Institutions (IFIs) were only providing a small level of support (as is usually the case in Middle Income Countries). Since the cost to access capital markets for Tunisia remains high (due to the risks associated with the transition period),[32] the authorities have decided to continue to rely mainly on external official financing in 2012 and 2013, and begin to return to capital markets with the benefit of guarantees by the US Government and the Japan Bank for International Cooperation (JBIC), and possibly IBRD partial guarantees (Table 4). This multidonor budget support package is expected to provide Tunisia approximately US$1.2 billion in 2012, including this proposed US$500 million equivalent DPL operation, which leverages a further US$500 million from the AfDB and a grant of Euro 110 million from the EU. In addition, in close coordination with this program, the US Government has also provided a US$100 million grant and a US Government guarantee which has enabled the Tunisian Government to raise US$485 million in financing from capital markets in July 2012 at a very competitive rate. The authorities have also raised an additional US$500 million through a dedicated sale of treasury bonds to Qatar in April 2012. The authorities are also in advanced discussions with Turkey on a US$100 million grant (of which US$50 million for budget support, US$30 for purchase of equipment from Turkey, and the balance of US$20 million for technical assistance) and an additional US$400 million loan at a competitive rate (of which US$200 million for budget support and the balance of US$200 million in a credit line for private sector import of Turkish capital goods). With that, international reserves are projected to remain at a lower but still adequate level of 3.1 months of imports in 2012 (or approximately US$7 billion) and begin to rise again thereafter.

[32] Shortly after the revolution, Moody's and R&I downgraded Tunisia's sovereign rating by one notch and Moody's changed the country's outlook from stable to negative. Fitch, S&P and R&I put Tunisia's BBB foreign debt rating on a negative watch. In March 2011, Fitch and S&P also downgraded Tunisia's foreign currency rating to BBB-, while S&P and R&I lowered its outlook for the country to negative in summer, reflecting its view that risks to the country's credit standing will persist. Most recently, S&P again downgraded Tunisia's sovereign rating by two notches (from BBB- to BB) in May 2012 citing ongoing political uncertainty.

Debt Sustainability

43. **Thanks to previous consolidation efforts, the public borrowing required to respond to the economic downturn in 2012 does not *per se* endanger Tunisia's fiscal and debt sustainability.** Prudent debt management and sustained growth reduced public debt from 52 percent of GDP in 2004 to 40 percent in 2010, of which almost 25 percent is foreign debt and the balance of 15 percent is domestic debt. The recent reduction in public debt has also brought down total external debt from above 60 percent of GDP in 2004 to 48 percent of GDP in 2010 (of which Medium and Long term debt was 37 percent of GDP in 2010). While external debt remains fairly high, its composition suggests limited risks for debt sustainability. In fact 38 percent of Tunisia's external debt is owed to multilateral donors and 20 percent of the debt is 'concessional'.[33] The maturity structure is also favorable, with 44 percent between 10 and 15 years and 18 percent between 15 and 20 years. Public debt and external debt levels are estimated to have increased by approximately 4 percent of GDP in 2011, as a result of the financing needs associated with the response to the crisis. The authorities have projected that the level of public debt will increase from 40.4 percent in 2010 to 44.6 percent of GDP in 2011, and will peak at approximately 47 percent of GDP in 2014 before starting to decrease again. The results of a Fiscal and Debt Sustainability Analysis (DSA) carried out by the Bank in 2012 (in collaboration with the authorities, and in consultation with the IMF) highlights that under a more prudent scenario (in terms of lower GDP growth and more gradual fiscal consolidation) the public debt ratio is projected to increase to approximately 47 percent of GDP in 2012, and to stabilize at approximately 55 percent of GDP by 2017 (Annex 9).[34] This higher level of public debt remains tolerable in comparison to the standard debt sustainability thresholds. The increase in public debt in 2011-2014 is expected to be reflected in an increase in external debt to approximately 54 percent of GDP in 2011, and reaching 59 percent of GDP by 2014.

44. **However, the DSA also confirms the need for Tunisia to return to a less expansionary fiscal policy stance over the next few years**. The DSA also highlights that the space for fiscal expansion is rapidly closing. Hence it is important to use the limited fiscal space wisely to accelerate growth, avoiding populist policies which structurally increase current expenditures and make it difficult in future years to reduce expenditures back to a level consistent with medium term fiscal sustainability. The DSA also highlights that debt sustainability is significantly affected by the level of GDP growth over the next few years, and therefore draws attention to the importance to accelerate the adoption of structural reforms to boost investment and accelerate economic growth.

Risks

45. **While the economy has started to recover in 2012, significant downward risks exist to the 2013-2014 economic outlook.** At present it is difficult to make projections about the performance of the economy in 2013 and 2014, notably due to the complexities of the domestic political process, the possible resurgence of social tensions in Tunisia, and the difficulties in implementing the investment budget. In addition, uncertainty with regards to developments in the Eurozone, the precarious stability in Libya, and the impact of high international food and fuel prices also pose significant risks to economic developments in Tunisia. While the number of strikes and sit-ins has diminished since February 2012, social tensions remain due to the high rate of unemployment. The increase in crime and frequency of security incidents, and the uncertainty about the political process has led many domestic and foreign investors to adopt a wait-and-see approach. In addition, difficulties in the financial sector could endanger the economic recovery. Banks' solvency is likely to be further challenged in the coming months as a result of the economic slowdown. Should such risks materialize, lower economic growth and additional pressure in the labor market could lead to renewed social

[33] This refers to historical commitments.

[34] These projections assume that the increasingly loss-making pensions system will be reformed in 2014. Further there are risks related to contingent liabilities in State Owned Enterprises, which could raise public debt by approximately 10 percent of GDP.

tensions and reinforce a sense of lack of economic opportunity. A recurrence of instability might lead to a renewed loss of foreign investors' confidence, which in turn could affect industrial production and exports, further depressing domestic consumption and slowing the economic recovery, and sending Tunisia into a negative spiral.

46. **In addition, the authorities now have less room for a flexible macroeconomic policy response.** Notably, the authorities have little room for additional monetary expansion in 2013-2014, because of the rise of inflationary pressures and risks of financial sector instability. Fiscal policy will also be increasingly constrained. While the authorities' goal is to minimize external borrowing, an unfavorable international environment and continued pressures to mitigate social tensions and stimulate the economy through fiscal measures may put pressure on the fiscal deficit 2012-2014.

47. **The Government of Tunisia is taking action to mitigate these risks and has available back-up options should the situation become more difficult.** In order to mitigate the risks mentioned above the authorities are aware of the need to keep a lid on public wages and curb subsidies. Similarly, in order to mitigate risks in the financial sector, the authorities have adopted measures to strengthen the stability of the banking sector, including launching audits of the three main state-owned banks and strengthening prudential measures (which are supported by this operation). Should it become necessary, the authorities have available approximately US$1 billion held at the central bank (which constitutes the balance of privatization receipts from the partial sale of *Tunisie Telecom* in 2006). Furthermore, while the macroeconomic situation is presently stable and the authorities have not requested IMF support, they have maintained an open and regular dialogue with the IMF. Should the macroeconomic situation deteriorate, the authorities are open to seek IMF financing.[35]

Overall Assessment of Macroeconomic Policy Stance

48. **The authorities initially sought to boost economic recovery in 2011 using a mix of expansionary fiscal and monetary policy.** While the effects of this policy mix have not been as strong as hoped for, and the room for accommodating macro policies has significantly diminished, the economy is gradually starting to recover. On the monetary side, the large liquidity injection, combined with the rise in international commodity prices since mid 2011, has resulted in inflationary pressures. On the fiscal front, while the authorities envisaged a significant increase in public investment, persistent administrative bottlenecks in the implementation of public investment projects has hindered these plans. On the other hand, the rapid increase in international food and fuel prices has led to soaring expenditures on subsidies while social pressures and demands for jobs has translated into public sector hiring and increased the civil service wage bill. Together, these exogenous and socio-political factors have resulted in a substantially different composition of public expenditures than envisaged in the supplemental budget.

49. **Given the increasing constraints to both monetary and fiscal policies, the authorities envisage that the future macroeconomic stance will gradually become more conservative.** The authorities have realized that monetary policy has reached its limits and future monetary expansion will necessarily have to be limited, and the Central Bank has already started to increase interest rates. Similarly, the authorities' Medium Term Fiscal Framework is based on a more conservative view of public investment spending and also reflects the need to control the wage bill and to rein in the food and fuel subsidies. However, implementing such expenditure control against the backdrop of continuing social pressures and in the run up to the 2013 elections will require significant efforts by the authorities.

50. **On balance, while weak economic performance in 2011 has reduced the Government's margins for maneuvering, the macroeconomic policy stance remains satisfactory and sustainable over the medium-term**. While the authorities now have less room for a flexible macroeconomic policy response, the situation is expected to be manageable even under a less optimistic scenario. The

[35] The IMF Article IV mission visited Tunisia in May 2012, and is supportive of the authorities' policy stance.

authorities are aware of the risks inherent in their somewhat optimistic projections and remain vigilant and ready to take further corrective action should it become necessary. Hence, while substantial risks remain to the macroeconomic outlook, the Tunisian authorities' macroeconomic policy stance remains sound and sustainable.

III. THE GOVERNMENT'S PROGRAM

DEVELOPMENT STRATEGY

51. **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 things, will reduce unemployment and regional disparities and improve living conditions throughout the country.

52. **The current Government prepared a supplemental budget law, which was approved by the Constituent Assembly in May 2012.** The supplemental budget increases the fiscal deficit to 6.6 percent of GDP in 2012 (compared to 4.5 percent in the original budget). As discussed in previous sections, the supplemental budget envisages a significant fiscal stimulus in 2012 (without jeopardizing medium-term macroeconomic sustainability). This increase in public expenditures is intended to mitigate social tensions and boost economic growth (especially in lagging regions) in order to prevent a recurrence of social unrest during the transition period.

53. **In parallel, the Government has prepared a medium-term socio-economic development strategy which seeks to reflect the aspirations of the population as expressed in the revolution and pave the way for stronger economic growth and job creation, particularly in lagging regions.** In order to boost economic growth, the Government has developed a medium-term plan based on five main pillars:

- Economic and social reforms: The program of economic and social reforms focuses on introducing the building blocks for good governance and improvements in the business environment, facilitating the restructuring of the economy, deepening economic integration and partnerships, and fostering the development of the financial system. To promote competition and improve the business climate, structural reforms will reduce regulatory barriers and administrative procedures; improving access to funding; as well as equal opportunities for public and private companies. The Investment code will be revised and simplified to aid investment, identifying opportunities for public private partnerships. The tax system will be reformed to promote investment and efficiency. Capital account liberalization will encourage FDI and investment across sectors, as well as partnerships between domestic and foreign companies. The Government is also committed to deepen integration into the global economy to boost growth, create new jobs, ensure transfer of technology, benefit from international expertise and attract funding. Comprehensive bilateral and multilateral programs are outlined in the strategy, including trade and tariff reform. Non-preferential rates and transaction costs will be reduced and new trade agreements signed to facilitate trade. Negotiations for further integration with the European Union will continue. Proposed financial sector reforms include consolidation of the banking sector, diversification of banking services including Islamic finance and international banks. Small and medium Enterprises (SMEs) will benefit from government supported microcredit programs, as well as new legal and institutional frameworks. The insurance sector will be further developed, including providing better products for Micro, Small and Medium Enterprises (MSMEs). Improved performance of the financial sector assumes a revitalization of market activity including Initial Public Offerings (IPOs), as well as banking intermediation. Other governance reforms envisaged include the strengthening of the institutional framework to tackle corruption, improve transparency, further enhance access to information and address inefficiencies in procurement/contract award procedures. The Government also aims to improve

the management of public funds via program budgeting and equally facilitate access to information, as well as active participation in budget decision-making. The Government also plans to revise the regulatory framework for public procurement. E-governance and e-government will further simplify administration and advance good governance. E-government processes—to improve the quality and reduce the cost of services—will increase citizens' access across regions, reduce discretion and foster competition and private sector activity.

- Modernizing infrastructure: To increase productivity and deepen integration into the global economy, including links between onshore and offshore sectors of the economy, the Government will work to extend logistics and transport networks. Port infrastructure will be upgraded, including via the construction of a deep water port at Enfidha (to be financed with private sector participation). Integration in the Maghreb region will be facilitated via road and rail connections to Algeria and Libya. The network of main highways will be renovated to better link economic and urban areas with lagging regions. Private sector financing will be sought for infrastructure projects in the inland regions.

- More balanced development across regions: Regional and local councils will be tasked with developing proposals in a decentralized 'democracy'. Regional council budgets will be revised to increase their financial management and responsibility. Furthermore, incentives will be provided to encourage investment (and promote human development) in lagging and interior zones based on regional advantages. Improving regional competitiveness is also a priority. To reduce regional disparities and improve development outcomes in marginalized areas, electrification, sanitation and access to safe drinking water will be increased—centering on the need for infrastructure and community facilities. Broadband telecommunications will be extended to industrial areas, university campuses and hospitals. Interior regions will also be connected to the natural gas network.

- Consolidating social and human development: The Government aims to strengthen human development indicators in terms of labor market participation and social disparities in livelihoods, health and education largely by reinforcing accountability, quality and modernization in the social sectors. This should entail a reform of the education system to better match the labor market outlook in the short and long term, including certification and accountability in secondary school, vocational training and higher education training. Enhancing health service delivery in lagging regions will help to reduce maternal mortality, malnutrition and waiting times, which otherwise increases out-of-pocket spending on health care and negatively impacts long-term poverty-reduction strategies. Targeted policies for public expenditures and social transfers can enhance programs for more effective strategies to improve opportunities for economic participation and mitigate poverty. Structural investments in lagging regions are needed to promote employment and public service delivery in health and education. Social assistance programs to support basic living standards, which account for less than 1 percent of GDP, can be enhanced by investments in targeting and assessing optimal amounts for cash transfers.

- Sustainable development and an efficient use of national resources: Sustainable development efforts will focus on efficient management of the natural environment, as well environmental monitoring and protection against pollution. Two key areas include coastal ecosystems and the fight against desertification—using desalination plants and rational use of water for agriculture. Sanitation in urban areas, including Greater Tunis, will be upgraded. Private sector investment will be encouraged in waste management concessions, and in operating and expanding landfills. The energy sector strategy will focus on the use of renewables, natural gas consumption and energy efficient buildings. The objective will be to increase fivefold by 2014 the share of renewables in energy consumption through wind and solar electricity.

REFORM PROGRAM FOR 2012-2013

54. **Based on the above development strategy, the Government has outlined an ambitious reform program for 2012-2013 focused on boosting economic growth and job creation, especially in lagging regions.** The Government's reform program is proceeding on two tracks. A first immediate economic priority is to ensure the effectiveness of the large fiscal stimulus approved in the May 2012 supplemental budget. In parallel the Government has launched an ambitious program of reforms to address key bottlenecks in the business environment, the banking sector, the labor market, social services, and to increase transparency and accountability. The program prepared by the Government reflects an effort to balance the demand for faster growth and sustainable job creation, to reduce the gap with lagging regions, and to introduce greater voice and improved transparency and accountability. This will provide a strong platform for the transition to restart the Tunisian economy. The Government has indicated it will not embark on sensitive reforms which could create social instability during the transition period (such as reforming fuel and food subsidies for the general public),[36] but it wants to adopt substantive and structural reforms to address key bottlenecks in the business environment, accelerate a more inclusive development process, particularly in lagging regions, and continue the governance reforms initiated under the 2011 program. As this programmatic DPL series supports this program of reforms, a brief description is provided below.

Execution of public investment projects

55. **To ensure the effectiveness of the fiscal stimulus, the Government has adopted a series of measures to accelerate the implementation of the investment budget.** Past experience in Tunisia has shown limited capacity in execution of public investments, and in 2011 the actual fiscal deficit was substantially smaller than the approved budget. In order to improve the execution of the fiscal stimulus approved in the May 2012 supplemental budget, the Government has carried out an extensive analysis of the problems facing public investment projects.[37] As a result of this exercise, in June 2012 the Government approved a ***revision of the public procurement Decree and regulations to simplify the rules for public procurement for urgent projects and give more responsibility to public procuring entities*** through: (i) the increase of shopping ceilings and (ii) the mandatory establishment of a procurement commission in each public procuring entity, in line with advice provided by the Bank. The Government also ***adopted a Circular reducing the delays and simplifying the procedures for the use and provision of commitment appropriations for public investment projects in 2012***. It also adopted a Circular to make available to all sector ministries the commitment appropriations allocated to them at the beginning of 2013, and to compile a list of all commitment appropriations by Governorate and by sector so that regional authorities will know which projects they are responsible for and the relevant budgets.

Investment climate and competitiveness

56. **In parallel, the Government has launched a series of reforms to improve the business environment and attract investment.** The economic environment under ex-President Ben Ali was

[36] Nevertheless, the Government has indicated it will keep the level of subsidies under control by increasing domestic prices as required (such as was done in September 2012 when the Government increased domestic fuel prices at the pump by 8 percent to limit the fiscal impact of the increase in international oil prices).

[37] The Ministry of Planning and Regional Development carried out an analysis of a sample of 1800 public investment projects to identify those which experienced long delays or were not completed, with a view to understand the challenges encountered. Some 800 projects of the total of 1800 projects spread over 24 governorates experienced serious delays/difficulties and the team identified different types of problems: access to land, difficulties related to the business cycle (including security situation), financial difficulties (lack of adequate budget allocation and overruns due to underestimation of costs or increase cost of building materials) and other various reasons (breach of contract, procurement procedures, over-time). Based on the analysis of the recurrent problems, Cabinet created and tasked four committees: (i) The Commission on Public Investment Projects entrusted to the Ministry of Planning and Regional Development; (ii) The Commission on Private Investment entrusted to the Ministry of Investment and International Cooperation; (iii) The Commission on Large Investment Projects entrusted to the Presidency of Government; and (iv) The Commission on Land Issues entrusted to the Ministry of State Properties and Land Affairs. These committees have proposed a large number of specific solutions to the problems identified which are currently being reviewed by Cabinet for adoption.

characterized by lack of transparency, cronyism, rent-seeking and related anti-competitive practices which discouraged entrepreneurship and private sector investment, preventing higher growth and employment. In order to address these problems the Government has launched reforms to remove red tape, reduce discretion and increase transparency in the regulatory and legal framework for investments, and to eliminate privileges and remove monopolies/concessions to allow greater market contestability and competition.

57. The Government has launched a process to ***revise the Competition Law and its institutional framework (Indicative Trigger for 2013 GOJ2 DPL)*** with a view to reduce its discretionary application and increase the transparency in the action of the Competition Authority. As part of this process, in July 2012 the Government ***clarified the division of competences between the Competition Authority and the Telecoms Regulator,*** in line with international best practice. The Government has also started to increase competition in key sectors, as in telecommunications, where the mobile market has become more open to competition, but where international telecommunications and backbone markets still have considerable barriers to entry and impose higher prices for voice communications and Internet access. The Government has taken steps to ***increase competition in international telecommunications (Prior Action for the 2012 GOJ DPL)*** and to open up ***access to alternative providers of fiber optic backbone infrastructure for telecommunications (Indicative Trigger for 2013 GOJ2 DPL).*** The Government also plans to enable greater competition and transfer of know-how to a larger number of sectors by ***extending the automatic authorization to certain types of foreign franchises***, particularly in fast food and real estate in 2012, and to additional sectors in 2013.

58. Many economic activities remain over-regulated or subject to abuse and discretion, and business surveys indicate that most firms consider excessive tax and regulations to be major constraints for doing business in Tunisia. With this in mind, the Government has expanded an initial pilot into ***a systematic and participatory reform process of simplification of the regulatory environment for investment (Prior Action for the 2012 GOJ DPL)***, based on streamlining of procedures, transparency, and reduction of arbitrary and discretionary behavior, and committing to deliver concrete reforms in the areas related to private investment by mid-2013. In order to improve the business environment and better attract investment, the Government has also launched a process to ***revise the Investment Incentives Code (Indicative Trigger for 2013 GOJ2 DPL)*** with a view to simplify it, improve its transparency, and streamline the process for the provision of investment incentives, rationalize the use of tax incentives and limit tax expenditure, and to reduce the dichotomy between the onshore and offshore sectors of the economy. In parallel the Government has prepared a ***Law on Public-Private Partnerships,*** which it expects to complete in 2012, to provide a legal framework for Public-Private Partnerships (PPPs) and enable the Government to better leverage the private sector in the financing and development of investment projects in the context of a transparent legal framework. As part of efforts to improve the investment climate, the Government is also preparing a ***revision of the Bankruptcy Law (Indicative Trigger for 2013 GOJ2 DPL)*** to modernize and simplify the process of restructuring firms and liquidating insolvent firms, with a view to ease the exit of poorly performing firms and in parallel decrease the number of Non-Performing Loans (NPLs). This will help improve financial stability and facilitate access of new firms to bank lending.

59. The tourism sector is a case in point. On the one hand, the sector has been afflicted for years by mounting debt. Many investors (including cronies of Ben Ali) benefited from very attractive investment incentives, including easy access to credit on favorable terms to invest in new hotels. A large number of hotels stopped servicing their debt, and in addition to creating a problem for banks, the situation is crippling the tourism sector as uncompetitive hotels have remained afloat and practice unfair pricing. The sharp downturn in the tourism sector in 2011, which saw a drop in revenues of 33 percent, has compounded the situation. Tourism sector debt represents the largest percentage of Non-Performing Loans (NPLs) on the balance sheet of the banking sector, and resolving this debt situation will play a critical role in strengthening the stability of the banking sector. The Government is preparing to ***address the problem of debt in the tourism sector through the creation of a dedicated***

Asset Management Company (Indicative Trigger for 2013 GOJ2 DPL) which will be tasked with facilitating the recovery of debts and restructuring unviable units.

60. Addressing the debt overhang is part of a broader "Tourism Sector Strategy 2016". To facilitate the sector's recovery, the Government has created a ***dedicated unit to implement its attendant Action Plan***. As part of the strategy, and in line with efforts to open more sectors to competition, the Government intends to ***liberalize transport services for the tourism sector,*** which were previously subject to restrictive licensing practices to the detriment of the sector's development. In addition, the Government intends to launch ***in December 2012 the negotiations for an "Open Skies" agreement with the EU*** and is preparing to adopt the relevant legal and regulatory convergence measures.

Banking sector stability

61. **The problems of Tunisia's banking sector extend beyond its exposure to tourism. The sector has for a long time been afflicted by political interference, weak governance, and loose regulation, resulting in weak intermediation capacity and performance.** Tunisia's banking system is burdened with structurally low profitability, tight liquidity, low solvency ratio and a high number of non-performing loans, and unless reformed it may not be able to play its catalyst role in economic development. This situation has been further aggravated by the economic downturn. Public banks are particularly affected.

62. In order to have a detailed assessment of the overall risks to which public banks may be exposed, in August 2012 ***the Minister of Finance, in agreement with the Central Bank, launched the process to commission strategic and financial audits of three public banks (STB, BH, and BNA) (Prior Action for 2012 GOJ DPL)***. Based on the results of the audits, the Government intends to launch a deep restructuring process of the relevant public banks in parallel with their recapitalization. In addition, while awaiting the results of the audits, ***the Government has already adopted a medium-term recapitalization plan for STB for 2012-2013 to enable the STB to reach the solvency ratio of 8 percent by end-December 2012, and has also approved temporary safeguards measures for STB***. In parallel, to enhance financial stability ***the Central Bank has strengthened banking prudential regulations (Prior Action for 2012 GOJ DPL)*** thereby starting a process of convergence in Tunisian banking sector prudential standards towards the best international practices in banking regulation. In addition, the Government is examining complementary ***measures to improve the governance of public banks (Indicative Trigger for 2013 GOJ2 DPL)*** in advance of receiving the results of the audits. As discussed above, these measures are complemented by the decision to create an Asset Management Company to restructure the debts in the tourism sector.

Labor markets

63. **Tunisia's unemployment problem cannot be solved in the short run.** As discussed above, the Government is adopting several structural reforms to improve the business environment and increase private sector investment to create higher value-added jobs that can absorb the fast growing number of university graduates, particularly women. In addition to removing obstacles to private sector investment, in order to accelerate job creation, reforms should aim to reduce distortions from excessively restrictive labor laws, very high labor taxes, and the large differential between remuneration and conditions in the public and private sector, as well as to ensure that the education sector gives the labor force skills that match market demand as the economy evolves.

64. To start a process of structural reforms of the labor market, the Government has ***launched a national dialogue process with the main trade union (Union Générale Tunisienne du Travail, UGTT) and the main business confederation (Union Tunisienne de l'Industrie, du Commerce et de l'Artisanat, UTICA), with the support of the International Labor Organization (ILO), aiming to sign a new Social Contract in January 2013***, which will pave the way for a reform of the Labor Code. In parallel, the Ministry of Social Affairs has also launched a study to review the fiscal sustainability of the social security system, supported by the Bank, with a view to reform the pension

system and health insurance. While these core reforms are being prepared, the Government is also pursuing complementary measures to improve youth insertion programs and facilitate women's participation in the workforce. Tunisia has plenty of programs for training and employment, most notably Active Labor Market Policies (ALMPs) programs funded by the National Employment Fund (Fund 21-21), but they have not proved particularly effective in matching labor demand to supply and in facilitating reinsertion. In this context, the Government has carried out a ***reform of the unemployment support programs financed by the National Employment Fund (Fund 21-21) (Prior Action for 2012 GOJ DPL)*** with a view to improve the design and strengthen monitoring of programs to support the unemployed, reduce frictional unemployment, and improve the operation of labor markets in Tunisia. In addition, the Government is preparing a ***reorganization and reform of the National Agency for Employment and Independent Labor (ANETI)***, with a view to reduce the heavy administrative burden required to administer its wage subsidy programs and strengthen ANETI's intermediation functions (such as job matching, registry of vacancies, and job counseling) to ensure greater responsiveness to market changes, reduce the employment search time, and increase the number of job offers accepted. The Government has also ***revised the Statute of the Public Service to align working hours flexibility with that in the private sector, helping working parents, particularly women, balance professional and personal responsibilities***. In addition, the Government is exploring additional measures to increase female participation in the labor force, notably the possibility to introduce a gradual improvement in maternity benefits in line with many countries that have recently reformed maternity and parental benefits and other policies to promote women's retention in the labor force.[38]

Social services

65. **There is a consensus that strengthening accountability and quality of public services is important to reduce social disparities, particularly in underserved regions.** In 2011, the Interim Government established a participatory process for systematically monitoring the performance of public services by civil society, citizens and service providers (*Prior Action for the 2011 GO DPL*). This system is now being implemented by the Prime Minister's office, which has published the results of feedback from citizens nationwide on 19 public services, and is being reinforced by the ***institutionalization of the participatory evaluation as one of the tasks of the Internal Audit Department for Public Services***. In addition, in May 2011, the Prime Minister (*Chef du Gouvernement*)[39] issued a Circular creating outreach services in underserved regions, using a participatory approach to provide a basic package of health, education and social protection services (*Prior Action for the 2011 GO DPL*).

66. The current Government wants to adopt longer-term strategic reforms to address structural bottlenecks in quality of public and private services, while creating new economic opportunities within the services sectors. In the education sector, a key challenge to job creation is to improve the quality and relevance of tertiary education, and promote excellence in leading universities through compliance with international standards. Accordingly the Government has ***established the 'National Authority for the Evaluation, Quality Assurance and Accreditation' as an autonomous agency for quality assurance in higher education (Prior Action for 2012 GOJ DPL).*** In order to produce the required outcomes, the quality certification will need to be accompanied by the provision of financial and academic autonomy to higher education universities and research institutes, and the Ministry of Higher Education has launched a national dialogue process on this issue. Similarly, in the health sector, the Government aims to address governance challenges posed by a lack of mechanisms regulating the quality of health care practices and infrastructure standards, and promote the adoption of international standards through official certification systems. Hence, the Government has ***created an autonomous agency for the accreditation and evaluation of health care services, structures and personnel (Prior***

[38] International Finance Corporation and World Bank (2012). *Women, Business and the Law Indicators.* Washington DC: International Finance Corporation and World Bank.

[39] In Tunisia, the Prime Minister is called the 'Head of Government' (*Chef du Gouvernement*) and is the highest ranking official in the executive branch, responsible with his team of Cabinet ministers for carrying on the business of government.

Action for 2012 GOJ DPL). In addition to ensuring that all hospitals and health centers comply with minimum national and international quality standards, this measure will support Tunisia in its health services export development strategy, including through cross-border services (often referred to as 'medical tourism') for which Tunisia has great potential due to the flow of patients that have been increasing in recent years.[40] The success of this strategy depends crucially on proof of quality and adherence to strict standards that are internationally recognized.

67. To better address social disparities the Government is also preparing a reform of social protection programs, notably to refine the targeting of beneficiaries and improve monitoring and evaluation of these programs. As a first step, the Government intends to ***establish a consolidated social protection information and verification systems for social transfer beneficiaries***. In parallel, the Government has also launched a study to examine options towards a gradual reform of fuel subsidies, with a view to replace them with direct cash transfers targeted to poor and vulnerable households. The reform of food and fuel subsidies, however, will not be carried out before the next elections.

Transparency and accountability

68. **Beyond issues of weak governance in the business environment, financial sector and social sectors, Tunisia has been characterized by weak levels of transparency and accountability across most dimensions of governance and anti-corruption.** Immediately following the revolution, the interim authorities initiated a broad program of emblematic reforms to strengthen governance and social accountability, which the Bank supported through the 2011 Governance and Opportunity DPL. As part of those reforms, the Interim Government revised the law on Freedom of Association to remove all major legal obstacles and facilitate the development of a strong and free civil society. The Interim Government also revised the legal framework to give the public the right to access information held by public bodies, including economic and social statistics (including micro data) (*Prior Action for 2011 GO DPL*). Despite early efforts of proactive dissemination of information on the government's website (statistical, administrative procedures, information on public finances), this new policy is not yet well known within the administration and the public. Hence the Government has adopted a Circular detailing ***the operational modalities of this law for civil servants and the roles and responsibilities with performance requirements, which will be reported quarterly (Prior Action for the 2012 GOJ DPL).*** The Circular was accompanied by an action plan for the implementation of this reform and including a training plan. The Government is also planning to strengthen the implementation of the Access to Information through the establishment in 2012 of an independent 'Information Commission' of experts who will monitor the implementation of the right to access to information, provide opinions/advice and handle citizens' complaints.

69. Similarly, in spite of initiatives taken following the revolution, much remains to be done to turn the process of preparing the budget into a more open and informed debate about priorities and budgetary decisions. ***Hence the Minister of Finance has issued a Decision instructing the relevant Departments to publish key information on public finances (Prior Action for the 2012 GOJ DPL), including a citizen's budget and an online open budget platform enabling citizen's direct access to detailed and timely public expenditure data.*** In addition the Government also changed the preparation process of the public investment budget and has adopted a bottom-up consultative approach, whereby local investment decisions take into account the input provided by local committees charged with consulting widely and identifying local priorities for public investment. Furthermore, the Ministry of Planning and Regional Development has developed a formula to inform the allocation of public investment resources (across the 264 delegations of the country) based on transparent and objective criteria.

[40] World Bank (2008). *Tunisia's Global Integration: Second Generation of Reforms to Boost Growth and Employment*. Report No. 40129-TN. Washington DC: World Bank.

70. In 2011 the Interim Government revised the legal framework for public procurement to improve the efficiency and transparency of procurement procedures and to shorten the decision process without compromising quality (*Prior Action for 2011 GO DPL*). In June 2012, the Government again adjusted the public procurement Decree and regulations to further simplify the rules for public procurement for urgent public investment projects. In parallel, following the 2011 revision of the Decree, the Government has evaluated its procurement system using the OECD/DAC methodology, and is now preparing ***an in-depth reform of the procurement systems to implement the key recommendations from the OECD/DAC study (Indicative Trigger for 2013 GOJ2 DPL).*** The OECD/DAC assessment has resulted in a detailed action plan. Further, the Government intends to launch a process of reform of all State controls systems by establishing a High Level Committee to guide and supervise the reform progress. As a first step in this process, the Government is introducing a reduction in the administrative controls *a priori* and moving instead towards granting the administration more autonomy and carrying out controls *a posteriori.* These reforms aim to strengthen the speed and efficiency of budget execution. In parallel, the Government has launched a diagnostic to strengthen the governance of State Owned Enterprises with a view to reforming the legislation regulating the governance of public enterprises.

71. The Government is also strengthening the Anti-Corruption legal chain. Following the ***establishment in November 2011 of the new Anti-Corruption Authority***, the Government nominated its president and members, and is establishing its operating rules. Further, in order to strengthen the capacity of the justice system to handle corruption cases, ***the Minister of Justice has established a dedicated Financial Crimes Investigative Unit of magistrates specializing in economic and financial issues*** in the First Degree Court of Tunis. The Unit will allow the investigation of complex corruption cases by creating a team of specialized magistrates. Looking ahead it will also reinforce transparency and competition in the economy by ensuring that corruption crimes do not remain unpunished. The Government's intention is to address the abuses of the past while not deterring 'clean' private investors.

IV. BANK SUPPORT TO THE GOVERNMENT'S PROGRAM

LINK TO THE COUNTRY INTERIM STRATEGY NOTE

72. **The World Bank Group's engagement in Tunisia has grown significantly since the revolution in January 2011.** In the mid 2000s, demand for Bank financing was steadily declining as Tunisia achieved investment grade status and accessed financing on the global markets. As a result of the global economic crisis, Bank lending to Tunisia sharply increased from US$6 million in FY08 to US$336 million in FY09. Immediately following the January 2011 revolution, the Bank responded rapidly to the Interim Government's request to help define and support priority actions to break with the past. Lending operations and analytical work that had been under preparation were put on hold while the Bank worked with the Interim Government to support post-revolution priorities. A new package of World Bank activities was agreed upon and focused on reform measures to promote governance, transparency and accountability, and alleviate the social impact of the economic downturn. The new program in 2011 included a US$500 million single-tranche multi-sector Governance and Opportunity Development Policy Loan (GO DPL) supporting reforms to (i) improve transparency and accountability in a visible way to respond to the aspirations of the population; (ii) signal to investors that Tunisia was creating a level playing field for private sector-led growth; and (ii) take immediate actions to relieve the plight of the unemployed and the poorest and most vulnerable groups. The DPL program was prepared jointly with the African Development Bank (AfDB), the European Union (EU), and French Agency for Development (AFD), who together contributed an additional US$800 million, for a total lending package of US$1.3 billion. Bank commitments in FY11 reached a record US$590 million.

73. **The Bank's program in Tunisia is set out in the Interim Strategy Note (ISN) for FY13-14 prepared in consultation with the Constituent Assembly Government**.[41] At present, the situation in Tunisia is too fluid for the Bank to lay out a full four-year strategy, particularly given the short-term horizon of this Government. A full Country Partnership Strategy (CPS) will likely be prepared after a new elected government under a new constitution is in place. The ISN outlines a Bank Group program focused on contributing directly and indirectly to Government's short and medium-term employment creation objective. The program promotes private-sector led recovery and job creation, with a focus on openness, opportunity and accountability. To this end, the World Bank Group's support is framed within three Areas of Engagement: (i) Laying the Foundation for Renewed Sustainable Growth and Job Creation; (ii) Promoting Social and Economic Inclusion; and (iii) Strengthening Governance: Voice, Transparency and Accountability.

74. **The ISN is guided by four principles of engagement:** (i) The Bank and IFC will seek to maintain *flexibility* in light of the fluid country context, to be able to adapt to the social and economic challenges of Tunisia; (ii) With a fluid and evolving political environment, the Bank Group will need to *be selective* in terms of the scope of its engagement in the different sectors where it will intervene, and in terms of the results it commits to helping Tunisia achieve during the ISN period; (iii) *Integrating gender* into new activities to maintain and advance women's role in Tunisia through the political transition is a priority for the Bank Group; and (iv) Broadening *consultations* to reach new stakeholders.

75. **The Bank supports the strategy of the Government to jump-start the economy using external official financing and its objective to gradually return to the capital markets for financing needs as the situation improves.** In 2011, Bank support focused on laying the ground for strengthening governance and promoting employment, particularly in regions previously neglected. The single-tranche US$500 million DPL, which leveraged about US$800 million in additional donor resources, helped signal confidence in Tunisia. This follow-up operation will assist the authorities raise financing for 2012. The proposed US$500 million GOJ DPL will leverage an additional US$700 million in donor resources. The Government is aware that fast-disbursing up-front support will increase IBRD's exposure more quickly. Nevertheless, as they face an urgent and large funding requirement for the fiscal stimulus and to service debt in 2012, they have requested a quick disbursing DPL. They also anticipate the need for additional DPL financing in 2013, possibly in tandem with a Policy-Based Guarantee (PBG) to gradually return to the capital markets (see Table 4). Hence, as part of this programmatic series, a follow up DPL operation (and/or PBG) is envisaged in calendar year 2013. The DPL series reform program focuses on measures to bolster competitiveness, promote exports and create employment, as well as to further strengthen governance, the transparent and effective delivery of public services, and transparency and accountability mechanisms. World Bank support in FY13 and FY14 will also include investment lending focused on private sector and export development, vocational training and employment programs, and urban/local development.

[41] The ISN was discussed by the Board of Executive Directors on 3 July, 2012. IBRD (2012), Interim Strategy Note for the Republic of Tunisia for the Period FY13-14, Report No. 67692 –TUN.

COLLABORATION WITH THE IMF AND OTHER DONORS

76. **The Bank has excellent collaboration with the European Union (EU), the African Development Bank (AfDB), and the French Development Agency (AFD), all of whom have a strong local presence in Tunisia. Relations with the IMF are also very close.** The IMF has no local office in Tunis and no formal program with Tunisia, although their relations are good. The Fund undertakes one Article IV mission a year and has technically assisted the Central Bank on monetary policy issues. The Government has not requested a Fund program at this stage. However the authorities invited the IMF for a brief technical mission to Tunisia in January 2012 and a full Article IV mission in May 2012 to examine possible macroeconomic scenarios. In addition, the Bank and Fund teams were invited to carry out a joint FSAP in January 2012. As indicated in the July 2012 Article IV report, the IMF supports the Government choice of accommodative fiscal policies in 2012 which are needed to mitigate the social tensions and boost economic growth and employment. The Fund team also underlines the uncertainty regarding the short-term economic outlook, mainly related to the outcome of the tourism summer season and developments in Europe. In particular, the Article IV report considered that: (i) the fiscal stance in 2012 strikes the right balance between supporting growth without undermining the longer term fiscal sustainability (and without squandering the significant gains achieved in bringing public debt down in recent years); and (ii) accommodating monetary and exchange rate policies are appropriate to support the economic recovery and ensure that adequate liquidity continues to be present in the banking system. The Bank has discussed with the IMF the reform content of this programmatic DPL series since its inception, and has coordinated closely particularly regarding the financial sector measures.

Box 1: A World Bank Group effort

Within the World Bank Group this operation has benefited from very close collaboration between the IBRD and IFC teams in supporting the design and implementation of the reform program. Joint IFC-IBRD missions were carried out to rapidly produce an in-depth diagnostic of the debt burden in the tourism sector, and recommended the setting up of an Asset Management Company. Similarly, the technical assistance of the revision of the Bankruptcy Law is being provided by a joint IFC-IBRD team. The IFC has also signed a technical assistance project to support the government in the preparation of the new Investment Incentives Code. Technical assistance on the regulatory simplification reform of business formalities is also being led by the IFC experts—and in fact the IFC already provided some technical advice since July 2012 in the implementation of the regulatory simplification pilot in the customs and tax administrations. Finally, IFC experts have also been mobilized and are providing advice to Government in the revision of the legal and institutional framework for competition.

77. **The proposed DPL operation has been jointly prepared by the World Bank Group (see Box 1), the AfDB and the EU.** The missions were conducted in coordination with AFD, a partner in the 2011 budget support operation, and with USAID as they identified reforms related to the US's cash grant and guarantee to Tunisia. The DPL builds on the successful experience of the 2011 Governance and Opportunity DPL prepared jointly by the government, the World Bank, the AFD, the AfDB, and the EU, which allowed these institutions to deepen the policy dialogue in 2012.

LESSONS LEARNED

78. **Lessons learned from implementing development policy loans in Tunisia and elsewhere show that country ownership of the proposed policies and actions is essential for success**. This program therefore supports closely the program of the Government, and is closely aligned to the expectations of the population, as expressed by the January 2011 revolution.

79. **Previous DPLs in Tunisia also highlighted the substantial benefits of preparing a joint budget support program with other development partners,** which resulted in greater commitment by the Government to identify a strong program, more synergies between the budget support program and the technical assistance and analytical activities carried out by the various donor agencies, as well as reduced transaction costs for the government and better overall donor coordination.

80. **The transition period provides a unique opportunity to introduce reforms which improve economic governance, transparency and accountability.** The 2011 GO DPL showed that there are significant reforms that can be introduced during the transition phase, if they directly tackle some of the injustices and bottlenecks which have been a source of frustration for the population. Notably reforms related to greater transparency, creating a level playing field, facilitating job creation, and facilitating development in lagging regions are at the top of the agenda.

81. **Multi-sector multi-donor DPLs are an effective instrument to consolidate the policy dialogue, which is especially valuable in a transition environment.** The successful experience of the 2011 GO DPL reflects to a large extent the fact that the operation facilitated a process to consolidate and prioritize the policy dialogue, which brought together the various ministries into a single dialogue with the main development partners. The operation also facilitated a centralized coordination of the reform program on the government side. This feature is especially valuable in a situation of transition, where the government has limited capacity to implement reforms and has to focus on a core set of priorities.

82. **Other lessons learned from implementing development policy loans in Tunisia and elsewhere also show:**

- The vital role of transparency, voice and social accountability mechanisms. In Tunisia, a yawning gap had emerged between *de jure* changes to policies and programs (some of them supported by previous DPLs) and *de facto* reality of their implementation. In the absence of feedback from society, it is in that gap that cronyism and corruption flourished (this is also a main theme of the 2009 World Bank report "*From Privilege to Competition: Unlocking Private-Led Growth in the Middle East and North Africa*").
- The limits of gradualism. Previous reform efforts have often focused on bringing gradual change where opportunities arose (e.g., in creating, then expanding the off-shore sector), on the assumption (untested in the absence of feedback mechanisms, see above) that society was only prepared for incremental changes. As it turned out, the January 2011 revolution demonstrated that the said society was actually hungering for quantum change.
- The importance of safeguarding banking stability in the transition. Experience from many other countries undergoing transition (e.g., Philippines, Indonesia, former Soviet Union, Eastern Europe) suggests that much of the legacy of the past may end up coalescing around bank portfolios. Preventing the related threats from becoming systemic is essential to securing the transition.

ANALYTICAL UNDERPINNINGS

83. **The proposed reform program build on existing analytical studies and rapid assessment missions recently completed as well as on projects that were under preparation in Tunisia.** A detailed summary of relevant analytical studies and technical assistance reports was presented in the Program Document for the GO DPL which is also relevant for this operation. Only additional reports, mostly carried out after the January 2011 revolution, and additional lessons which are relevant for this operation, are summarized below:

- **Business environment:** Substantial analytical work has been carried out in Tunisia on barriers to private sector development. Shortly after the revolution the main findings of this work were synthesized into an internal Policy Note on Barriers to Growth and Job creation in Tunisia (Mimeo, February 2011). In 2010 the Bank also provided the Government a Policy Note on the International Best Practice for the Revision of the Investment Incentives Code (February 2010). An Investors Motivation Survey has been carried out in 2012 with the IFC, which highlights the limited role of fiscal incentives in attracting investment. The Bank has also recently launched the preparation of an Investment Climate Assessment which for the first time will provide a comparable base to other countries in the region/world in terms of

barriers to investment and private sector growth. In 2012 the Bank also launched the preparation of a new Development Policy Review (DPR) focusing on attracting investment and creating jobs (expected early 2013), and also a new Options for Global Integration report (expected late 2012). Several of the background analytical studies for the new DPR are being used to inform the preparation of the reforms for this programmatic series. Notably, substantial work is ongoing on indentifying barriers to competition including an in-depth assessment of the legal framework; and also a note which highlights the problems with limited competition in the Information and Communications Technologies (ICT) sector and barriers to the development of the sector.

- **Financial Sector:** A Financial Sector Assessment Program (FSAP) report was prepared jointly by the Bank and the Fund in January 2012. The report provides a detailed analysis of banking sector stability issues, microfinance, debt markets, and its recommendations informed the proposed reforms in the financial sector component of this operation, notably on banking sector stability. Prior to the FSAP, an internal Policy Note on the Financial Sector in Tunisia was prepared following the revolution (Mimeo, February 2011). This note highlighted how the limited role of the banks is largely due to problems related to the governance of the commercial banks, and suggesting reforms to improve the State governance of public banks. In addition, two joint IBRD-IFC missions were fielded in December 2011 and January 2012 to examine in depth the situation of the debt in the tourism sector, and the findings of these missions (which have been written up in internal reports, shared with the authorities) have informed the proposed reforms in this operation to accelerate resolution of the debt burden paralyzing the tourism sector.

- **Labor markets and unemployment**: There is ample analytical work carried out on employment in Tunisia which provides a solid background for the medium term policy objectives of this operation. More recently, several lines of fresh analysis have been carried out, including an internal Policy Note on Labor Markets in Tunisia (Mimeo, April 2012) which provides an update of the recent trends up to and including 2011, and presents options for a package of short terms measures that could be implemented to mitigate high unemployment over the next few years, with particular focus on the low-skilled and long term unemployed. As part of the ongoing 'Employment Technical Assistance' activity and of the 2013 DPR, additional analytical work is also advanced to examine wages and remunerations (including on the existence of gender discrimination), the rigidity in hiring and firing and other provisions in the labor code, and the problems of job search and school-to-work transition. This work highlights the role of high taxation and labor code rigidities/distortions in discouraging 'good quality' job creation, and also highlights the distortions that the relatively higher public sector remuneration-benefits plays in segmenting the labor market, resulting in greater unemployment. As part of the follow up to the 2011 GO DPL the Bank has also prepared an in-depth report on the reform of the National Employment Fund (Fund 21-21) which highlights structural problems in the organization of the *Agence National pour l'Emploi et le Travail Independent* (ANETI; the public agency which implements most Active Labor Market Programs) and also highlights substantial overlaps in the programs supported by the Fund 21-21. This report provides the analytical backbone of the reforms pursued in this operation.

- **Social Sectors:** The social sectors program was informed by studies which have revealed that a lack of accountability for quality in social services contributes to lagging human development and labor market outcomes (see GO DPL Program Document). The analysis shows that women face geographic and economic barriers in accessing basic primary care in lagging regions, resulting in higher maternal mortality rates which can be reduced through better accountability and regulation of the quality and availability of service delivery. An analysis of governance and productivity in the health sector also shows that the potential for the sector to generate jobs is high through more coherent public-private partnerships,

harmonization with international standards of quality, and improved insurance coverage (Productivity and Governance Health Sector Policy Note, mimeo, April 2012). A Policy Note on Social Sectors Expenditures in Tunisia (mimeo, February 2011) demonstrated that while the level of spending in the social sectors is average as compared to middle-income countries, the lack of governance and transparency limits the potential for health and education sectors to keep up with international competitiveness. The analysis also shows that social inclusion in Tunisia can be supported through greater outreach to lagging regions in terms of improved targeting of livelihoods support (cash transfers) and aligning the quality of health and education through transparency and more strategic investments in primary health care and secondary education. Studies on Equity of Access to higher education highlight the links between higher education and employment outcomes, particularly for women. The 2012 report on University Governance underscores the importance of accountability and quality assurance in strengthening the quality of higher education and its relevance to labor market outcomes.

- **Governance:** The governance reforms have been informed by the recommendations of two in-depth governance assessment missions (Governance Assessment Mission Report, February 2011 and October 2011), which stressed the importance of strengthening government accountability and transparency as the paramount objective in the short and medium term. The findings of the February mission was summarized in an internal Policy Note on Governance Issues in Tunisia (mimeo, February 2011). The main findings and recommendations of these missions have informed the design of the measures proposed in the 2011 GO DPL and also pursued in this DPL. Finally, the 2010 Public Expenditure and Financial Accountability (PEFA) identified transparency and accountability shortcomings, notably in the field of financial information and reporting, public procurement, the tax authority, internal and external financial controls. The authorities finally published this report in 2011, and have indicated they are committed to implement its main recommendations. In addition, as agreed during the preparation of the 2011 GO DPL operation, the Government has carried out an evaluation of its procurement system using the OECD/DAC evaluation which was finalized in June 2012, and the findings will inform the reform of the procurement code envisaged under the second operation of this series.

Table 5. Studies and Reports, TA activities, and Investment Projects, related to the proposed DPL operation

DPL Pillar / reform area	Studies and Reports, TA activities, and Investment Projects	Leading Institution
Macroeconomic framework	Debt Sustainability Analysis (April 2012) Economic Monitoring Note, Spring 2012 (Mimeo, 2012) Economic Monitoring Note, Fall 2012 (Mimeo, 2012) IMF 2012 Article IV Consultations with Tunisia (July 2012) Tunisia Development Policy Review (2010)	World Bank World Bank World Bank IMF World Bank
Business environment	Tunisia Development Policy Review (expected 2013) Tunisia Second Global Integration Study (expected 2012). Report of Investors Motivation Survey (Mimeo, 2012) Tunisia Development Policy Review (2010) Policy Note on the International Best Practice for the Revision of the Investment Incentives Code (February 2010). Tunisia Global Integration Study (2008). PSD Flagship Report on Competitiveness (2009) Tunisia ICT Sector Development Project 2004-2010 Tunisia ICT Sector Policy Note (Mimeo, 2012)	World Bank World Bank World Bank World Bank World Bank World Bank World Bank World Bank World Bank
Labor market and unemployment	Policy Note on Labor Markets in Tunisia (Mimeo, May 2012) Strategic Assessment of National Employment Fund (Mimeo, June 2012) Tunisia Development Policy Review (2010) PSD Flagship Report on Competitiveness (2009) Tunisia Employment DPL II (preparation suspended) MILES I: Skills Development, Social Insurance and the Labor Market (Policy Note, FY07) MILES II: Labor Demand, Skills Supply and Employment (Policy Note, FY09/10)	World Bank World Bank World Bank World Bank World Bank World Bank World Bank
Financial sector	Financial Sector Assessment Program (February 2012) Policy Note on Financial Sector (Mimeo, February 2011) Mission report on stress tests (Mimeo, May 2011) Mission report on governance of commercial banks (Mimeo, 2011) Mission report on State governance of public banks (Mimeo, 2011)	World Bank World Bank World Bank World Bank World Bank
Social sectors	Policy Note on Social Sector Expenditures in Tunisia (Mimeo, November 2011) Tunisia Equity in Higher Education and Employability Study (2010) Benchmarking University Governance Study (2012) Tunisia Health Sector Productivity and Governance Policy Note (2012) Policy Note on Regional Development and Municipalities in Tunisia (Mimeo, February 2011) Tunisia Health Services Strengthening DPL (preparation suspended) Health Equity Study (2010)	World Bank World Bank World Bank World Bank World Bank World Bank
Governance	Governance Assessment Mission Report (Mimeo, October 2011) Governance Assessment Mission Report (Mimeo, February 2011) Procurement Review using the OECD/DAC methodology (July 2012) Tunisia Development Policy Review (2010) Doing Business 2012 Tunisia PEFA 2010 PSD Flagship Report on Competitiveness (2009)	World Bank World Bank GOT/WB/AfDB World Bank World Bank World Bank World Bank

V. THE PROPOSED GOVERNANCE, OPPORTUNITY AND JOBS DEVELOPMENT POLICY LOAN

MAIN FEATURES OF THE OPERATION

84. **The proposed Governance, Opportunity and Jobs (GOJ) DPL is the first in a proposed programmatic series of two operations which supports the transition period in Tunisia.** This series builds on the program launched in February 2011, when the Interim Government requested the Bank to prepare a multi-sector DPL, jointly with a multi-donor team.[42] The current Government has now requested the Bank to lead the preparation of a follow-up multi-sector program of reforms to underpin a new multi-donor budget support operation.

85. **The development objective of this GOJ operation is to help Tunisia lay the policy foundations for a more competitive business environment, a strengthened financial sector, more inclusive and accountable social services, and more transparent public governance.** In this context the operation (and indeed the programmatic DPL series) supports a program of measures that consolidate the governance reforms introduced with the 2011 GO DPL,[43] and launch a program of economic reforms to accelerate growth and job creation. A core theme across all reforms is to improve transparency and accountability and foster a level playing field (whether by reducing excessive regulations and limiting discretion in their application, by introducing quality standards and monitoring systems, and by giving the public access to information on the operation and performance of the government). These issues underscore the core failures in public sector governance and business environment under ex-President Ben Ali. The reforms are expected to result in greater domestic investment and FDI inflows, improved solvability of the banking sector, the adoption of quality measurement/standards and greater accountability in public services provision (notably health and education, but also unemployment services and social protection programs), greater access to information by the public and greater transparency in the use of public funds. Realizing these objectives will help to consolidate the democratic transition and accelerate economic recovery.

86. **The overall GOJ program has been prepared by the Government with joint support by the World Bank, the African Development Bank (AfDB) and the European Union (EU), with the participation of the French Development Agency (AFD) and US Agency for International Development (USAID). The overall program is summarized in the Joint Policy Reforms Matrix (Annex 3).** All preparatory missions were jointly conducted even if some flexibility was needed to respond to different processes. The Bank played the leading role to coordinate the work across institutions, to communicate with the Government, and evaluate the macroeconomic framework for this program.

87. **The total amount of financing to the Government under the first phase of the GOJ operation is expected to be approximately US$1.2 billion in budget support.** The budget support will include a US$500 million equivalent loan from the World Bank and a further US$700 million equivalent from other development partners (amounts discussed so far include US$500 million loan from the AfDB and Euro 110 million grant from the EU). In addition, in close coordination with this program, the US Government has also provided a US$100 million grant and a US Government

[42] At that time the Interim Government indicated they wanted to undertake a program of immediate measures which would demonstrate the change in direction called for by the revolution, and set Tunisia on a new medium-term trajectory of reforms. The interim authorities chose to give priority to measures which would signal "a clear break with the past", notably to increase equity, transparency, voice and accountability, but did not feel they had a mandate to undertaken structural reforms to improve the economy.

[43] A brief overview of progress in the implementation of the reforms introduced by the 2011 Governance and Opportunity DPL is provided in Annex 5.

guarantee which has enabled the Tunisian Government to raise US$485 million in financing from capital markets in July 2012 at a very competitive rate.[44] The funding will be provided through separate financing agreements for each institution on the basis of the same Joint Policy Reforms Matrix.

CONSULTATIONS ON THE REFORM PROGRAM

88. **The Government has consulted broadly on the reform program supported by this operation, which has been published online for public comments.**[45] The Government has consulted broadly on the proposed reform program, discussed in Section III, which is supported by this DPL. The main areas of reform are explicitly referred to in the Government's 2012 program which was presented and published online on the government internet portal in May 2012 (http://www.pag2012.gov.tn). In addition, in September 2012 the Government published online the detailed reform program supported by the development partners (see also the Joint Policy Reform Matrix in Annex 3), with a feedback loop for comments by citizens (http://www.tunisie.gov.tn/index.php?lang=french or http://www.tunisie.gov.tn/index.php?lang=arab). This type of online interactive consultation is rapidly becoming a standard practice in Tunisia. Subsequently, in early October 2012, the Government held a public workshop to discuss the detailed

Box 2. Good Practice Principles for Development Policy Lending

Ownership: The government program supported by this operation has been announced publically (online) by the Government in September 2012, and is focused on consolidating the changes in governance and transparency initiated under the 2011 program and adopting reforms to accelerate growth and job creation. The policy actions supported by this operation are basically measures identified with the government to reach specific outcomes objectives of the Government. They focus on key measures that the Government believes are necessary to set Tunisia on a new medium-term growth trajectory and politically possible.

Harmonization: Agree upfront with the government and other financial partners on a coordinated and accountability framework. The program is jointly supported by the World Bank, the African Development Bank, and the European Union (and in collaboration with the French Development Agency and USAID) and there has been very effective collaboration between these development partners throughout its preparation. The content of the program and its underpinnings have thus been naturally coordinated with Tunisian institutions. The policy matrix was carefully discussed and coordinated.

Customization: Customize the accountability framework and modalities of Bank support to country circumstances. The policy matrix reflects the Government's priorities and lessons learnt by the development partners in supporting similar programs of the Government in the past. The Bank has been flexible in both the loan amount and government's preferences in terms of the preparation schedule.

Criticality: Choose only actions that are critical for achieving results as conditions for disbursement. The Government has asked the Bank to maintain the focus of this program on three areas: economic growth, inclusive and regional development, and governance, i.e., all crucial parts of the Government's program. Within that context the operation is focused on measures, in line with the demands of the revolution, which increase equity, transparency, voice and accountability, and set Tunisia on a new medium-term growth trajectory.

Transparency and Predictability: Conduct transparent progress reviews conducive to predictable and performance-based financial support. The selected prior actions can be effectively monitored, providing predictable and performance based financial support.

[44] As indicated above, the grant and guarantee by the US Government do not use, *stricto sensu,* the same policy matrix, but support measures which strengthen the implementation of the reforms supported by the 2011 GO DPL operation.

[45] As part of the preparation of this operation, the development partners also held meetings with civil society and private sector in June 2012, mainly to listen and brainstorm about the country's priorities. The team was careful not to overstep its role in consulting directly on the Government's program, and to let the Government lead its own consultations process. In its discussions with the authorities, the team made it clear since the beginning that it expected the Government to carry out a broad process of consultations.

program of reforms with stakeholders. The event was attended by some 70 representatives from Non-Governmental Organizations (NGOs), private sector representatives and the media (including public and private televisions, newspapers and online media). The Deputy Minister of International Cooperation presented all the reform measures and the Governor of the Central Bank discussed those measures related to the financial sector. A few NGOs indicated that they wished the Government had consulted them earlier in the process, but also appreciated that the program had been posted on line. There were concerns about the measures on opening up the economy to foreign companies and franchises which are perceived as threatening local jobs (small corner shops) and hence an exhortation for Government to proceed cautiously by gradually opening a few sectors and monitoring the impacts.

89. **In addition the Government is conducting the preparation of the key reforms in a participatory manner with key stakeholders (notably Trade Unions and Employers Confederations).** As part of the preparation of the high-profile reforms (and notably those related to the Investment Code, the Bankruptcy Law, the Competition Law, and the regulatory simplification reforms), the Government has planned a phase for external consultations to seek feedback by relevant stakeholders on the details of the reforms and/or has formed consultative groups with key stakeholders that meet regularly during the preparation of the reform.

POLICY REFORM PROGRAM

90. **The GOJ DPL policy matrix and results framework presents the specific areas supported by the Bank's DPL series.** The Policy Matrix of reforms supported by this DPL is presented in Annex 2, as well as the expected reform program envisaged for the next operation in 2013. While not included in the matrix in Annex 2 (for simplicity), it should be underscored that there is significant continuity from reforms supported under the earlier 2011 GO DPL operation. The proposed package of reforms supported by the GOJ DPL constitutes a subset of the larger program supported by the donor partners which is presented in the Joint Policy Reform Matrix supported by the donor partners (in Annex 3).

91. **The prior actions have been selected based on their criticality for achieving the objectives set forth by the current Government.** The measures supported by the GOJ DPL are based on three main guiding criteria: (i) being implementable within the mandate of this Government, which is expected to cease in Spring 2013; (ii) reinforcing reforms launched under the 2011 GO DPL to enhance voice, accountability, citizen rights, and service delivery particularly in underserved regions and for underserved populations; and (iii) tackling feasible reforms with a medium term/long-lasting impact to boost economic growth and job creation. A balance has been struck between the critical importance of ownership, the required ambition of the reform program as well as realism and effectiveness of implementation within the timeframe of the program and the exceptional circumstances which Tunisia is experiencing. The Bank is committed to accompany the implementation of these reforms beyond the adoption of the relevant legal and institutional framework to ensure their effective implementation.

92. **The GOJ DPL policy matrix describes the logic of the program**, by showing for each of the four pillars of the program the main axes through which the main objective is expected to be attained, the key actions and the specific measures to be implemented during the course of the program. As summarized in Box 3, the proposed GOJ DPL policy matrix includes nine prior actions that Government has fulfilled prior to presentation to the Board of this operation. These prior actions are indicative of the richer reforms which are being undertaken by the Government (as reflected also in the broader Joint Policy Reforms Matrix in Annex 3). As discussed above, the reform program underpinned by the matrix is directly linked to the implementation of the reform program of the current Government, notably with regards to attracting investment and job creation, strengthening the financial sector, improving the quality and accountability in social sectors services, and strengthening governance, transparency and accountability. The detailed prior actions supported by this operation and the expected results are discussed below.

Box 3. Summary of Prior Actions for the Governance, Opportunity and Jobs (GOJ) DPL and Indicative Triggers for the Second Governance, Opportunity and Jobs (GOJ-2) DPL

Prior Actions for the GOJ DPL (2012)	Indicative Triggers for the GOJ-2 DPL (2013)
Attracting investment and job creation	
• Prior Action #1: The Government has launched a systematic and participatory regulatory review process of business formalities to streamline procedures, increase transparency, and reduce the room for arbitrary and discretionary behavior by public officials; and committing to deliver concrete reforms within 9 months, in the areas related to private investment. • Prior Action #2: The President of the National Telecommunication Council has issued a decision to open up access to the landing stations of international telecommunications cables to more operators (in addition to *Tunisie Telecom*).	• The new Bankruptcy Law has been published in the National Gazette. • The new Investment Incentives Code has been published in the National Gazette. • The revised Competition Law has been published in the National Gazette. • The President of the INT has approved a technical and price offer by the three holders of alternative fiber optic backbone infrastructure (SNCFT, TA and STEG) to lease capacity to licensed operators on a non-discriminatory and cost-oriented basis.
Strengthening the financial sector	
• Prior Action #3: The Minister of Finance has issued the call for Expression of Interest to commission strategic and financial audits of the three public banks, namely the *Société Tunisienne de Banque (STB)*, the *Banque de l'Habitat (BH)*, and the *Banque Nationale Agricole (BNA)*. • Prior Action #4: The Governor of the Central Bank has issued a Circular outlining stricter prudential regulations for the banking sector, gradually moving towards international best practice.	• The Law establishing an Asset Management Company to deal with the debts in the tourism sector has been published in the National Gazette. • The Minister of Finance has strengthened the governance of public banks by increasing the independence of their Boards and management teams.
Improving the quality of social sector services and inclusive policies	
• Prior Action #5: The Government has consolidated and streamlined job insertion programs financed by the National Employment Fund and established a monitoring and evaluation framework to assess the impact of employment programs on beneficiaries' labor market outcomes. • Prior Action #6: The Government has instituted in the health sector an autonomous auditing, evaluation and accreditation system of the quality of health services using standards harmonized with international accreditation bodies. • Prior Action #7: The Government has established the National Authority for the Evaluation, Quality Assurance and Accreditation of higher education.	
Strengthening governance, transparency and accountability	

• Prior Action #8: The Government has specified the procedures for the implementation of the 2011 Decree-Law on the right by the public to gain access to documents held by public agencies. • Prior Action #9: The Minister of Finance has issued a Decision on the publication of key information on public finances, including a Citizen's budget and an online open budget platform giving citizen's direct access to detailed and timely public expenditure data.	• The Government has revised the Decree defining the national public procurement system (implementing the key recommendations of the OECD/DAC review) has been published in the National Gazette.

Prior Action #1: Simplification of the regulatory environment for investment

Decree No.2012-1682 (*"Décret relatif à la mise en place d'un processus participatif pour l'évaluation et la révision des procédures administrative régissant l'exercice des activités économiques*") dated August 14, 2012, institutionalizing a systematic and participatory reform process of business formalities, based on streamlining of procedures, transparency, and reduction of arbitrary and discretionary behavior; and committing to deliver concrete reforms within 9 months of its publication, in the areas related to private investment, has been published in the National Gazette No.72 dated September 11, 2012.

93. *Rationale***:** For over a decade, Tunisia has implemented a significant number of reforms to simplify administrative burdens,[46] yet their impact and credibility suffered from the unequal and discretionary application of rules, cronyism and privilege both in the economic and administrative spheres. In addition, the process by which such reforms were designed also limited their impact and credibility in the eyes of investors and citizens: weak participation by users, lack of a systemic and coordinated approach, as well as insufficient communication and transparency in measuring outcomes and the quality of service. Moreover, attention was often focused on simplifying procedures without systematically questioning the social objective behind existing regulations. As a consequence, many economic activities remain over-regulated or subject to abuse and discretion. Tunisia's informal economy is estimated to be equivalent to 30 percent of GDP, with 27 percent of this informality due to excessive regulatory burden in the market (IMF, 2011).[47] Tunisia ranked 59 out of 180 economies in Transparency International's Corruption Perception Index in 2010.

94. In the wake of the revolution, reducing discretion, cronyism and arbitrariness in the administrative and regulatory environment is a priority and expectations are very high. While the problems of discretion and arbitrariness in the enforcement of regulations will require deeper and longer term institutional reforms, simplifying regulations to reduce opportunities for discretion will substantially help address this problem. Doing so in a credible way and sending a strong signal that change in this area is structural and set to last requires a totally new approach to administrative reform, both in terms of pace, comprehensiveness and process. In order to address this issue, a first round of reforms was started in 2011. A Circular issued by the Interim Prime Minister in May 2011 and a subsequent *Arreté* by the Minister of Finance launched a systemic, participatory, regulatory reform process to simplify administrative procedures and red-tape and reduce discretion and arbitrariness in the customs and the tax authorities (***Prior Action for the 2011 GO DPL***). The participatory regulatory simplification has been proceeding steadily, albeit with some delays. It is expected that out of 446 formalities identified in the tax and customs, only 7 percent will remain untouched, while

[46] This includes the development of e-government initiatives, or the replacement of prior authorizations for business entry with declarative systems subject to predefined sectoral specifications.

[47] http://www.imf.org/external/pubs/ft/reo/2011/mcd/eng/pdf/mreo1011.pdf
Also, in 2006, the *Institut d'Economie Quantitative* (IEQ) published a report on Tunisia's competitiveness on the basis of a survey of manufacturing enterprises. Most firms considered excessive tax and regulations to be major constraints for doing business in Tunisia, and they believed that this raises labor costs.

approximately 8 percent will be eliminated, and a further 85 percent will be significantly simplified. The final report has been prepared and should be submitted to the Council of Ministers in November to approve the package of reforms. Based on this positive experience, the Government has now decided to extend the same 'guillotine' approach to business formalities, which is being part of the reform program supported by this programmatic DPL series.

95. *Policy reform:* The same methodological approach will now be applied to most administrative steps related to private investment. Hence the Government has issued the Decree No. 1682 dated August 14, 2012, institutionalizing a systematic and participatory reform process of business formalities, based on streamlining of procedures, transparency, and reduction of arbitrary and discretionary behavior; and committing to deliver concrete reforms within 9 months, in the areas related to private investment. The adoption of the Decree launches a systematic time-bound participatory review of administrative formalities and regulations against predefined assessment criteria of (i) regulatory necessity, (ii) legal coherence, (iii) process efficacy and efficiency, and (iv) the extent of opportunity for discretion, ambiguity and arbitrariness in the administration of the rules.[48] Each concerned agency will have to provide justification for each regulation or procedure it administers, within a timeframe monitored by the Prime Minister's office. Inspired by similar experiences in the OECD (Sweden, the Netherlands, or Mexico) and in countries that have experienced substantial economic or political transitions (South Korea, Croatia, the Czech Republic or Ukraine), the design of the reform will be spear-headed by the Department for Administrative Reforms, in the Prime Minister's office, building on existing experience in Tunisia (particularly in the Ministry of Finance) and will be adapted to the local administrative environment and current context.

96. *Expected results:* In the short-term, the measure will lead to a substantial reduction in compliance costs with investment related formalities (by at least 20 percent by end 2014). In the longer-term, the reform process launched through this decree will enhance transparency and limit discretion of administrative decisions and processes, as well as improve efficiency in delivery key regulatory services/transactions. Furthermore, the reform will reduce costs and risks of doing business, as well as improve fairness in application of the rules to firms and citizens. By leveling the playing field and strengthening competition, this reform process is expected to open up new opportunities for investment and job creation, including opportunities for women and young entrepreneurs**.**

Prior Action #2: Increasing competition in the telecommunications sector and improving access to the internet

The President of the National Telecommunication Authority has issued Decision No. 67/2012 (*"Décision No. 67/2012 de l'Instance Nationale des Télécommunications en date du 4 Octobre 2012 portant sur le complément de l'Offre Technique et Tarifaire d'Interconnexion de la Société Nationale des Télécommunications pour l'année 2012, relative à l'accès à la station terrienne d'atterrissement des câbles sous-marins*") dated October 04, 2012, to open up access to the landing stations of international telecommunications cables to more operators in addition to Tunisie Telecom.

97. *Rationale:* Until January 2011, Tunisia implemented a gradual approach to telecom liberalization, and it restricted Internet content and limited public access to certain websites. Moreover, heavy restrictions on the creation of and access to digital content and rules to create and register websites prevented instead of fostered their development.[49] Since the January 2011 revolution

[48] It should be emphasized that the review exercise will focus on removing unnecessary regulations and reducing discretion in the application of existing rules, but will not remove the necessary health and environmental safeguards (which entail a rigorous Environmental Impact Assessment framework), as well as labor protection/standards.

[49] The policies on internet access were in stark contrast with other measures that Tunisia was taking to foster the ICT sector, such as to extend technical training, liberalize the telecommunications sector, and incentivize small companies and ICT start-ups. Further a new 3G license was awarded to *Tunisiana* in early 2012, and the INT has recently reduced termination rates

all Internet access controls have been removed. The Government also approved a new 'Domain names Charter', which establishes a more liberal environment, through elimination of the a priori control, and elimination of the requirement that only domestic Internet Service Provides (ISPs) can be registrars (***Prior Action for the 2011 GO DPL***). In addition, an electronic registry has been established to facilitate the practical registration of websites. As a result, the number of **.***tn* websites increased from only 8,000 websites in April 2011 to almost 15,900 websites in July 2012. Thanks to sustained competition, and to the entry of a third mobile operator, mobile penetration exceeds 120 percent, and mobile rates witnessed a healthy reduction during the first half of 2012.

98. **Unlike the mobile market which has become more competitive, the international telecommunications and backbone markets have considerable barriers to entry**. These barriers stifle competition, impose higher prices for voice communications and Internet access, and reduce the '*confiance numerique'* in Tunisia. The main bottlenecks are:

- The market structure for international telecommunications in Tunisia restricts entry. In EU countries international and backbone connectivity is fully open to competition.[50] *Tunisie Telecom* has a *de facto* monopoly on international connectivity through the control of all landing stations in the country[51], when in Eastern Europe for instance there are on average ten providers in this market segment.
- All international traffic is still routed through *Agence Tunisienne de l'Internet (ATI)*, an agency identified by the Tunisian population as a tool of censorship and repression during the previous regime. ATI applies a 30 percent markup on wholesale prices. The role played by ATI in the past is well known to the population and depresses the '*confiance numerique'*. ATI is not technically necessary and Tunisia's arrangement is unique.
- *Tunisie Telecom* is also a dominant operator in the area of domestic backbone connectivity.[52] Substantial additional fiber optic infrastructure has been put in place by various State Owned Enterprises (*STEG, SNTCF* and *Tunisie Autoroutes*) but can only be used by them for their own corporate needs.[53] Enabling these companies to rent out access to their alternative backbone infrastructure could introduce strong competition to *Tunisie Telecom*, reducing the prices of domestic and international connectivity.

99. *Policy reform:* In order to remove these bottlenecks and strengthen competition in backbone and international communications, the National Telecommunication Authority (*Instance Nationale des Télécommunications, INT*) has issued a Decision to open up access to the landing stations of international telecommunications cables (currently controlled by *Tunisie Telecom*) to more operators**.** By allowing the three licensed operators (*Tunisie Telecom*, *Tunisiana* and *Orange*) open access provisions on the landing stations, including co-location, this Decision will introduce competition in the international telecommunications market. In addition, to enable the use of alternative backbone infrastructure the INT also intends to approve by November 2012 a technical and price offer by the three holders of alternative fiber optic backbone infrastructure (*STEG, SNCFT* and *Tunisie Autoroutes*) to lease capacity to licensed operators, to the ISPs and to "private" networks (e.g. networks of schools, networks of private banks etc), on a non-discriminatory and cost-oriented basis **(*Indicative Trigger for 2013 GOJ2 DPL).*** In parallel the Government will also amend the concessions of licensed operators,

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on mobile networks, which has reduced mobile communications prices significantly. These factors will further stimulate mobile access, putting pressure on the existing backbone and international network.

[50] For instance, bandwidth per capita in Eastern Europe is between four and ten times higher than in Tunisia, and as a result prices are a fraction.

[51] Tunisia has also terrestrial links with Algeria and Libya, through its participation in the *IBN KHALDOUN* cable. All infrastructures are controlled by *Tunisie Telecom*.

[52] We cannot talk about a monopoly in this market segment, but of dominant position. In competition to *Tunisie Telecom*, *Office Nationale de Telediffusion (ONT)*, a State-Owned Enterprise, leases its radio links and high points to licensed telecom operators. *Orange* and *Tunisiana* have the right, *de jure*, to develop their own infrastructure.

[53] The only exception is SNTCF, which has leased the ducts in the Tunis-Sfax line to Tunisiana, which has installed its own fiber optic infrastructure along the railway lines.

eliminating the need to route traffic through ATI for their Internet Protocol (IP) traffic. It will also amend the licenses of Internet Service Providers (*Fornisseur de Service Internet*, FAI) to explicitly include the right to offer VoIP services to their final clients. As a complementary reform, the Government of Tunisia has announced its decision to divest its ownership of 25 percent of the capital of *Tunisiana* (one of the 3 mobile operators), through a sale to financial investors. The offers will be received by November 2, 2012.

100. *Expected results:* The expected benefits of this reform are substantial. The price of international telecommunications is expected to drop over the medium term (from approximately 40 US cents/minute in 2011 to 20 US cents/minute in 2013 and 10 US cents/minute in 2014), and volume of calls per capita to increase four fold. The price of IP international bandwidth is expected to decrease by 25 percent in the short term and up to 50 percent by end 2014. A first rough estimate puts the consumer welfare benefit at US$72 million per year. These results will increase the competitiveness of Tunisian companies benefiting SMEs and large companies alike, and also significantly increase the attractiveness of Tunisia as an offshoring destination. In addition it is expected that investment in backbone and international infrastructure will increase (as by comparison Eastern European countries have on average 10 international operators). Finally, network redundancy and network security will increase, reducing the possibility that physical damage to a landing station will harm Tunisia's access to the Internet.

Prior Action #3: Launching of Strategic and Financial Audits of three public banks, and adoption of a recapitalization plan of the STB, with related safeguard measures.

The Minister of Finance has issued the call for Expression of Interest to contract one or more firms to carry out strategic and financial audits of the three public banks, namely *Société Tunisienne de Banque* (STB), *Banque de l'Habitat* (BH), and *Banque Nationale Agricole* (BNA).

101. *Rationale:* The weak performance of the Tunisian banking sector during the Ben Ali period was known to be rooted, among others, in insufficient corporate governance practices as well as a lax regulatory and supervisory framework. A new Circular to improve the governance of the banking sector was issues by the Central Bank in May 2011 (***Prior Action for the 2011 GO DPL***) to address the main governance shortcomings.[54] In recent months the banks have also had to face a difficult economic environment, notably related to their exposure in the tourism sector, which has been severely affected by the impact of the revolution after January 2011. While credit continued to grow at a rapid pace (in part because of the increase of the overdraft facilities), the quality of banks' portfolio has decreased in 2011, putting downward pressure on their solvability ratio and prompting the Central Bank to inject massive liquidity.

102. This has most affected most the STB (the largest bank in Tunisia), whose regulatory capital fell below the required threshold of 8 percent. This State Owned Bank, considerably weakened after it absorbed two distressed former development banks in the early 2000s, has for a long time been subject to conflicting demands resulting in poor performance. STB has been required to be profitable, to diversify and to compete with private banks while fulfilling missions on behalf of the State. Its governance arrangements were loose, with Board of Directors and senior management expected to serve the interests of shareholders (including minority investors), to manage direct State interventions, and to comply with all prudential regulations. In practice however, the Minister of Finance never gave STB the means to carry out all these tasks efficiently. In turn, the Central Bank has not strictly enforced the prudential requirements. In fact, STB has never fully recognized the losses incurred in its loan portfolios, which resulted in adverse effects on the level playing field in the Tunisian banking system and also its own viability.

[54] In particular, all banks, including the State-owned banks, have to appoint a minimum of two independent board members by July 1st, 2012.

103. *Policy reforms:* Even if the main difficulties of the three public banks are known to its main shareholder (the State), and by the Central Bank, they do not have a complete vision of the overall risks to which the banks may in fact be exposed and of the options available to tackle them. Mindful of these ongoing problems, the Minister of Finance, in agreement with the Central Bank, has decided to commission strategic and financial audits of these banks, and to start to increase the STB's solvency buffer while awaiting the results of the audits. Hence on August 24, 2012 the Ministry of Finance posted the Request for Expressions of Interest to select one or more international firms to carry out strategic and financial audits of the three public banks (STB, BH, and BNA). In addition, the Board of the STB (in which the Government is the main shareholder) has adopted a decision to increase the capital adequacy ratio of STB, through (i) the conversion of external debts into equity and (ii) a medium term recapitalization plan for 2012-2013 to enable the STB to reach the solvency ratio of 8 percent by end-December 2012. It has also adopted temporary safeguards measures while awaiting the results of the audit.[55]

104. *Expected results:* These measures (strategic audits, programmatic recapitalization plan to reinforce solvability, and reform of the governance of public banks) will enable a consolidation of the financial situation of STB, BH and BNA, while refining the analysis of the risks faced by the bank and allowing to steer the strategic choices of the Government relating to the actions required to ensure the stability of the banks. The recapitalization of STB will allow the bank to improve its intermediation capacity and its capacity to invest in a sustainable way.

Prior Action #4: Strengthen key aspects of the prudential regulation in the banking sector

The Governor of the Central Bank has issued Circular No. 2012-09 ("*Circulaire aux établissements de crédit No. 2012-09 relative à la division, couverture des risques et suivi des engagements*"), dated June 29, 2012, revising the Circular 91-24 dated December 17, 1991 outlining stricter prudential regulations for the banking sector.

105. *Rationale:* Despite recent improvements (notably Circular 2012-02 on collective provisions), prudential regulations in Tunisia seems insufficiently restrictive and/or poorly applied by credit institutions on a number of aspects. This is particularly true of certain provisions of Circular 91-24 on the division, the coverage of risks and the monitoring of commitments.

106. *Reform measure:* Hence the Governor of the Central Bank has revised Circular 91-24 to strengthen prudential regulations. Notably, the revision has strengthened the following aspects: (a) increase of the minimum solvency ratio: gradual increase to 9 percent by end 2013 and to 10 percent by end 2014 (Article 4); (b) make permanent the general provisions introduced by the circular 2012-02 for the fiscal year 2011 (new Article 10 bis); (c) require banks to deduct from their regulatory capital the participations they hold in other credit institutions (including the related debts) (Article 5); (d) increase the risk weighting factor from 100 percent to 300 percent for risks in excess to the risk division rules (new Article 6 ter); (e) restrict large exposures by lowering the standards of 5 times the net capital for loans exceeding 5 percent of the capital to 3 times that level and from 2 to 1.5 times for loans exceeding 15 percent of net capital (Article 1); (f) lower the threshold from 3 times to 1 time the capital on outstanding loans granted to officers, directors and shareholders whose shareholding exceeds 10 percent (Article 3) and expand the notion of beneficiary to persons referred to in Article 23 of Law 2001-65 (Article 3).

107. *Expected Results:* The reform is expected to result in an increase in the minimum Capital Assets Ratio (CAR) for the banking system from 8 percent in 2011 to above 9 percent by end-2014 and a decrease in the large exposures. The gradual tightening of prudential regulation will enhance

[55] Mainly the non-distribution of dividends for at least two years and, at least, until the STB has constituted a provision amounting to the debt swapped into equity (i.e., TND 117 million).

financial stability and send a clear signal that the Tunisian banking sector has begun a process of convergence towards the best international practice in banking supervision.

Prior Action #5: Reinforcing the effectiveness and governance of Active Labor Market Policies

Decree No. 2369 (“*Décret No. 2012-2369 fixant les programmes du Fonds National de l’Emploi, les conditions et les modalités de leur bénéfice*”) dated October 16, 2012, which revises Decree No. 349-2009 dated February 09, 2009, setting the programs of the National Employment Fund, has been published in the National Gazette No 82 dated October 16, 2012.

108. *Rationale:* Tunisia’s unemployment problem is the result of a host of factors. Firstly, there is a need to improve the business climate to stimulate more investment, leading to an overall increase in the demand for labor. Removing labor market rigidities is a critical part of this agenda. Reforms should aim to reduce distortions from excessively restrictive labor laws, very high labor taxes, and the large differential between remuneration and conditions in the public and private sector. In addition, higher education in Tunisia is not a well performing sector and there is ample evidence of misalignment on the labor supply side as well which itself impairs greater private investment. While the bulk of the unemployment needs to be addressed through greater labor demand and better labor supply, a significant number of vacancies annually remain unfilled in Tunisia suggesting that strengthening ALMPs to reduce frictional unemployment also plays a role. Finally, the level of unemployment has been exacerbated by the negative economic performance in 2011, such that it will be appropriate to adopt short term measures to address this cyclical component.

109. As part of the reforms supported by this programmatic DPL series the Government is adopting several reforms to improve the business environment and increase private sector investment to create more and higher value-added jobs that can absorb the fast growing number of university graduates, particularly women. In addition this series also supports measures to enable the education sector to give the labor force skills that match market demand as the economy evolves. In order to launch a process of structural reforms of the labor market, the Government has launched a national dialogue process with the main trade union (UGTT) and the main business confederation (UTICA), with the support of the ILO, aiming to sign a new Social Contract in January 2013, which will pave the way for a reform of the Labor Code. In parallel, the Ministry of Social Affairs has also launched a study to review the fiscal sustainability of the social security, with support by the Bank, with a view to prepare a reform of the pensions system and health insurance. While revising labor market regulations and reforming the social security system is critical and the Government is already working in this direction, these structural reforms are politically sensitive and will necessarily require a time frame which goes beyond the transition period. Hence, in terms of the labor market, the reforms supported by this DPL series focus on complementary ALMPs measures to improve youth insertion programs and facilitate women’s participation in the workforce.

110. Tunisia has plenty of programs for training and employment, but they have not proved particularly effective, particularly in promoting adequate opportunities for recent university graduates, women, and youth. Prior to the revolution, the National Employment Fund (NEF; also known as Fund 21-21) was a presidential fund financed directly by the Treasury which worked in a very centralized manner and was regarded as highly politicized. Although it was also used for other purposes, the fund financed primarily: (i) regional programs for employment; (ii) entrepreneurship programs; and, (iii) active labor market programs (ALMPs), mainly on-the-job training programs accompanied by a monetary stipends *(Programmes d’insertion dans l’emploi salarié*), implemented by the National Agency for Employment (ANETI).[56] Since 2009, the Fund 21-21 has been the main source of funding for these ALMPs, all of which remain generally poorly assessed (and the monitoring system of the

[56] The NEF resources are significant at approximately TND460m in 2011 (about 0.8% of GDP). The NEF is the main source of financing for Active Labor Market Policies and regional development programs, benefiting more than 405 thousand individuals every year.

programs is inadequate).[57] In April 2011, the Interim Government launched a reform of the Fund 21-21 aiming to improve its governance and ensure that it will be used to finance better designed and rigorously monitored programs to support the unemployed, reduce frictional unemployment, and improve the operation of labor markets in Tunisia. In this context, the Bank and other development partners supported the Government efforts to transform the National Employment Fund into an effective instrument to assist the unemployed based on international best practice.

111. As a first step, in 2011, the Government transferred the management of the Fund 21-21 from the Presidency to the Ministry of Employment and Vocational Training to improve its governance and ensure that the programs it finances focus on tackling unemployment (***Prior Action under the 2011 GO DPL***). In parallel, the Bank provided technical assistance to carry out an institutional assessment of the Fund 21-21 programs with a view to re-design some of the programs and to introduce a monitoring and evaluation systems for the programs financed by the Fund. The report has highlighted several main gaps which need to be addressed to complete the reform of the NEF:

- *The need for consolidation of employment insertion programs:* Existing employment insertion programs (SIVP, CIDES, CAIP, CRVA, SCV)[58] consist primarily of wage subsidy for internships that allow companies in the private sector to benefit from subsidized labor for a period of between 12 and 24 months. However, the architecture of these programs remains inadequate and requires burdensome administrative processes that are magnified due to program fragmentation. This undermines the capacity of ANETI counsellors to perform their intermediation and prospecting functions. Further, while some of the programs require firms to hire a share of the beneficiaries after program completion, this rule is largely unenforced. As a result, the quality of internships offered by firms is generally low and enterprises generally do not invest in the human capital of the interns.
- *The introduction of a monitoring and evaluating framework for the ALMPs:* Decree 349-2009 prescribed the monitoring and evaluation of ALMPs, but did not spell out appropriate procedures. While ANETI has a monitoring system in place that registers the number of beneficiaries by program, results-based monitoring and program evaluation is largely inexistent. Hence the impact of ALMPs on beneficiaries and firms employment outcomes and productivity remains largely un-assessed.
- *Reform of public works programs:* The Fund 21-21 finances regional programs, mainly public works, through the so-called *Contrat Emploi Solidarité (CES).* These programs are implemented by local authorities in a top-down manner. The selection of sites and workers, as well as their implementation, is carried out by the office of the governor in collaboration with line ministries at the local level, without the participation of the community and/or civil society.
- *Reorganization and reform of the National Agency for Employment and Independent Labor (ANETI):* The agency was created (under the law No. 93-11 of February 1993) to execute employment promotion policies and programs. The Labor Code gives ANETI the monopoly

[57] In order to tackle youth unemployment Tunisia has been investing heavily Active Labor Market Policies (ALMPs), and spends about US$70 million annually on ALMPs targeted to university graduates who are new entrants to the labor force, mainly consisting of paid internship programs, reaching 138,670 job seekers in 2010. While ALMPs provided by ANETI constitute important mechanisms to provide first time job seekers with experience and financial support, they have hardly been successful at helping beneficiaries transition into permanent employment, especially in disadvantaged regions where program's placements rates are below 15 percent (e.g., in Sidi Bouzid and Gabes; for comparison OECD benchmark placement rates for on-the-job training programs are above 80 percent). Regional employment programs are also perceived as not successful as the programs do not accommodate to the region's needs and economic context. Data collected by ANETI's monitoring system is not being analyzed rigorously and the impact of ANETI programs on employment outcomes (beyond insertion rates) remains largely unknown.

[58] SIVP: Stage d'Initiation a la Vie Professionnelle; CIDES: Contrat d'Insertion des Diplômés de l'Enseignement Supérieur; CAIP: Contrat d'Adaptation et d'Insertion Professionnelle; CRVA: Contrat de Réinsertion dans la Vie Active ; SCV: Service Civile Volontaire.

on the provision of placement and intermediation services in Tunisia. However, as discussed above in practice ANETI mainly administers employment wage subsidies, and this administrative burden has undermined ANETI's intermediation functions (such as job matching, registry of vacancies, and job counseling). Moreover, ANETI's institutional and procurement frameworks restrict its capacity to partner with private operators of employment services and/or to associative organizations to provide employment and intermediation services to the unemployed.

112. *Reform measure:* In order to continue the reform of Fund 21-21, the Prime Minister has issued the Decree No. 2369 dated October 16, 2012, which revises Decree 349-2009 setting the programs of the National Employment Fund (Fund 21-21). This reform involves: (i) the consolidation of employment insertion programs (SIVP, CIDES, CAIP, CRVA, SCV) into two new programs that will be implemented by ANETI though public private partnerships: a "training voucher" (*Chèque pour l'amélioration de l'employabilité*) and a "wage voucher" (*Chèque d'appui à l'emploi*);[59] (ii) the establishment of an institutional and legal framework for monitoring and evaluation of ALMPs; and (iii) the reform of regional programs, by allowing civil society and the private sector to identify and implement public works and regional employment programs financed by the Fund 21-21.

113. *Expected results:* In the short term this measure is expected to result in higher employment insertions rates of program beneficiaries as well as to increase in the number of ANETI programs that have social-auditing/process evaluations, and the preparation of periodic results-based Monitoring Reports for ALMPs. It will also lead to an increase in the number of regional public works programs financed by the Fund 21-21 that are implemented by NGOs (to reach at least 50 programs by end-2014). Over the medium term, this measure aims to strengthen the effectiveness of active employment policies in terms of: (i) improving program insertion rates; (ii) improving the stability and quality of jobs for young people and women; (iii) strengthening the monitoring of program performance including indicators for key populations such as youth and women; and, (iv) improving the capacity of employment services, reducing the employment search time and the number of offers not met.

Prior Action #6: Establish an evaluation and accreditation system in order to strengthen the governance and quality of health services.

Decree No. 1709 ("*Décret No. 2012-1709 portant création de l'instance nationale de l'accréditation en santé et fixant ses attributions, son organisation administrative, scientifique et financière ainsi que les modalities de son fonctionnement*") dated September 6, 2012, establishing a National Authority for the Evaluation and Accreditation of Health Services and setting its administrative, financial and operational modalities, has been published in the National Gazette No.72 dated September 11, 2012.

114. *Rationale:* Tunisia seeks to enhance economic integration by accelerating trade, investment and job creation, particularly in knowledge-intensive sectors such as the health sector.[60] Ensuring that services adhere to international standards through accreditation is key to that strategy: where asymmetry of information prevails in the health sector, recognition of quality through accreditation and certification are key to ensuring a viable sector and investment. Accreditation has been shown to

[59] The training voucher will finance training costs (between 100 and 200 hours of training) and will provide a cash transfer of TND150 per month for as long as individuals participate in training activities (maximum 12 transfers) and can be used within a period of 24 months after the beneficiary registers in ANETI as a job seeker. Beneficiaries can only benefit from 12 months of assistance each unemployment spell. Providers will be paid based on their capacity to connect beneficiaries with existing vacancies—to ensure that the training provided is demand-driven. The wage voucher will subsidize a share of the wage and social security contributions for 12 months for first time job-seekers upon signature of an employment contract. The reform also aims to reduce the burden of managing ALMPs (by allowing ANETI to sub-contract some of the administrative functions for the new programs), and allow ANETI to allocate more resources to the intermediation function.

[60] World Bank (2008). Tunisia's Global Integration: Second Generation of Reforms to Boost Growth and Employment. Report No. 40129-TN. Washington DC: World Bank.

improve quality in health services and is standard in most OECD countries, as well as India, Indonesia, Turkey, and Jordan to name a few. While Tunisia has in place a relatively well-distributed infrastructure, quality varies a lot. Further disparity in access to and quality of services is wider in Tunisia, which is particularly evident in the higher rates of maternal mortality which has been associated with poor quality of services in Tunisia's western regions. Approximately 50 percent health services users in the public sector, particularly in lagging regions, expressed dissatisfaction in 2012 mainly because of the low quality of treatment received by personnel, the lack of medicines, the obsolete equipment and long waiting times.[61] [62] As a result, there has been an increased use of private clinics, accounting for 30 percent of all visits as of 2012. The private sector employed 50 percent of all doctors at least part-time as of 2008, and delivered 70 percent of high-end technology services.

115. Job growth in the health sector in Tunisia already has exceeded overall job growth over the past decade, and continues to have a large potential. Jobs in the health sector grew by 72 percent during 1998-2008 as compared to an overall rate of employment growth of 22 percent.[63] As a share of the total labor force in Tunisia, the health sector went from accounting for 1.5 percent of the labor force in 1998 to 2.5 percent in 2008. This trend in growth is seen in many developed countries, where health accounts for up to 1 in 10 jobs, the majority being non-medical jobs in management, maintenance, information technology, legal services, auditing, engineering, and educational services.[64] Trade in health services is considered as an important source of future growth in Tunisia, currently accounting for 150,000 foreign patients as of 2009, as compared to 250,000 in Jordan and 1 million in Thailand. Further expense is linked to Tunisia's capacity to ensure and enforce quality standards.

116. *Reform measure:* The Prime Minister has issued the Decree No. 1719 dated September 14, 2012, to institute an auditing, evaluation and certification system of quality in the health sector using standards set by international accreditation bodies. The measure will require that health facilities conduct routine evaluations of quality based on standards harmonized with those set by international accreditation bodies, such as the Joint Commission International (USA) and the *Haute Autorité de la Santé* (High Authority for the Health Sector, in France). The measure also establishes an autonomous National Authority for managing the evaluation and accreditation of health services delivery and to coordinate efforts on waste management with Tunisia's existing environmental agencies. This initiative builds on Tunisia's proven experience with ISO certification as well as certification through its environmental protection agency, the *Agence Nationale de Contrôle Sanitaire et Environnemental des Produits* (National Agency for Health and Environment Control of Goods, ANCSEP) since 1999. Additional resources are gradually being transferred to hospitals to support upgrading as part of performance contracting since 2010. Responsible staff has been appointed to hospitals to reduce interruptions to service delivery. As of 2011, the Ministry of Health completed pilots of quality evaluations in preparation for accreditation of two hospitals, thereby setting a precedent that capacity exists for accreditation evaluations using international standards.

Expected results: This measure is intended to improve the quality of services in the medium term. Accreditation will boost quality, trade in health services, investment and job growth in the health sector at large: health services, equipment and pharmaceuticals. Jobs in the sector also tend to attract men and women alike, opening up opportunities to increase women's labor force participation for low and highly-skilled jobs. The main expected result in the short-term is to have by end-2014 at least 10 percent of hospitals that have initiated the accreditation process by conducting evaluations of the quality of service delivery using international standards. Transparency towards citizens will also be an

[61] Tunisia Quality of Service Delivery Survey, 2012.

[62] Accreditation is just one of policies that are needed. Tunisia has in place lagging regions incentives and has been increasing investments in health infrastructure in lagging regions. The Ministry of Health started upgrading infrastructure and rehabilitation through an investment program and increased budget allocation to underserved regions, but the high regional variation in practices and infrastructure standards would be reduced through evaluation and accreditation mechanisms.

[63] Tunisia Ministry of Health, 2011, and ILO Key Indicators of the Labor Market (KILM) Database, 2012.

[64] For example, the United Kingdom's National Health Service was the single largest employer in Europe in 2009, accounting for 7 percent of the British work force, or nearly 2 million people. United Kingdom National Health Service (2010). "About the NHS". http://www.nhs.uk/NHSEngland/thenhs/about/Pages/overview.aspx (accessed May 19 2010).

important aspect of the accreditation process, so the involvement of citizens and publication of assessment reports are also expected. The objective of the measure is to improve the quality of health services, particularly in disadvantaged areas, by ensuring that all hospitals comply with national and international quality standards. The measure should also support Tunisia in its health services export strategy development through medical tourism for which reputation and quality standards are essential. In the long-term, the measure will be accompanied by the integration of certification as part of contracting with the public and private sector.

Prior Action #7: Strengthen the quality of higher education provision

Decree No. 1719 ("*Décret No. 2012-1719 fixant la composition de l'instance nationale de l'évaluation, de l'assurance qualité et de l' accreditation et les modalities de son fonctionnement*"), dated September 14, 2012, establishing the National Authority for the Evaluation, Quality Assurance and Accreditation of higher education, has been published in the National Gazette No.73 dated September 14, 2012.

117. *Rationale:* As discussed above, a key challenge to job creation is to improve the quality and relevance of tertiary education. With that in mind, the 2008 Law for Higher Education provides for the establishment of an independent quality assurance agency to evaluate all institutions and programs and guarantee that their services meet international standards and serve national economic and social needs. In addition this law proposes to increase autonomy of higher education universities and research institutes, to make them more responsive to current needs. The Ministry of Higher Education and Scientific Research (MHESR) has initiated a series of steps to evaluate Universities and programs through the establishment of a National Evaluation Committee *(Comité National d'Evaluation, CNE)* which has laid the basis for the establishment of an autonomous quality assurance agency as stated in the 2008 Law for Higher Education. This agency will be responsible for assessing the quality of programs and institutions which is essential in making the universities accountable for their quality towards the citizens and the private sector. The transformation of the *Comité National d'Evaluation* (CNE) in a system of accreditation and quality assurance requires the establishment of an autonomous and financially self-sustaining agency—the National Authority for the Evaluation, Quality Assurance and Accreditation *(Instance Nationale de l'Évaluation de l'Assurance Qualité et de l'Accréditation*, INEAQA)—and a revitalization of quality assurance units at each university. Pending the formal establishment of such institutions, substantial progress has already been made in developing accreditation capacity. The World Bank through the Investment Loan to support the Higher Education System (PARES II), has been providing support and technical assistance to the MHESR to implement the law, and in particular to establish the Independent Quality Assurance Agency, and develop the capacity at the MHESR and at each University to conduct internal and external evaluations. To date, the MHESR has conducted 33 evaluations of programs, in most cases with participation of international experts, and have made recommendations to universities to improve their current standards. At the University level, Quality Units have been established in all Universities, and through PARES II staff is being trained to perform their relevant tasks.

118. *Reform measure*: The Prime Minister has issued the Decree No. 1719, dated September 14, 2012, for the establishment of the National Authority for the Evaluation, Quality Assurance and Accreditation of higher education and promulgated implementing regulations: (a) establishing the composition, working procedures of the National Authority for the Evaluation, Quality Assurance and Accreditation; (b) designating the President and members of the Authority and setting their allowances and allowances for members of the expert commissions in charge of operations assessment (as provided by Law No. 19 of February 25, 2008 on higher education, Title IV, Articles 42 and 43), and (c) adopting a timetable for the implementation of the Authority.

119. *Expected results:* The establishment of this body should ensure a higher quality of supply and promote excellence in leading universities to gradually comply with international standards and

eventually improve their rank. It is expected that by end-2014 at least 40 programs will have been evaluated by the Authority.

Prior Action #8: Access to information

The Head of Government has issued Circular No. 25-2012 (*"Circulaire No. 25 [concernant] l'accès aux documents administratifs des organismes publics"*), dated May 5, 2012, specifying the procedures for the implementation of the Decree-Law 41-2011 dated May 26, 2011 which aims at promoting transparency and harmonizing the means and procedures regarding public access to documents held by public agencies.

120. *Rationale:* After the revolution, the Government wanted to mark a break with the past practices of secrecy and responded positively to requests from civil society by adopting a policy on access to information. Decree-Law No. 41-2011 on access to documents held by public agencies was adopted April 26, 2011 and strengthened in June 2011.[65] This new policy and law have a very broad scope, covering the entire public sector and all information created, apart limited legal exceptions. Its effective implementation requires disclosure of specific rules for officials and the establishment of clear procedures and standards both within the administration as well as towards the public (form, request and complaint procedure). Similarly, senior managers should be appointed in each public body and receive precise terms of reference for the implementation of this law. Finally, a monitoring and evaluation system must be established.

121. Despite early efforts of proactive dissemination of information on the Government's website (statistical, administrative procedures, information on public finances) this new policy is still little known within the administration and the public.[66] Civil society and the media are very critical about the limited results of this policy and the absence of clear and transparent rules to enforce it.

122. *Reform measure:* In response, the Prime Minister has issued Circular No. 25-2012 dated May 5, 2012, specifying the procedures for the implementation of the Decree-Law 41-2011 on the right by the public to gain access to documents held by public agencies. This circular sets out the main categories of information disseminated by the government, the procedure to request information and template, the terms of reference of information officers, the complaint procedure and forms, the objective criteria of exclusion (personal data, security, intellectual property, etc), as well as templates for the quarterly monitoring and evaluation reports on the implementation of the Decree-Law by public bodies. The circular will be complemented by a detailed action plan for the implementation of this reform and including a training plan. This is to strengthen the effective implementation of the new policy of transparency and access to information. The Government is also working to establish an independent commission of experts ('Information Commission') which will be in charge of monitoring the implementation of the right to access to information and to provide opinions/advice

[65] Such legislation establishes a presumption that all information held by public authorities, broadly defined, would be accessible. It also establishes minimum standards for the proactive publication of information in the public interest, including by providing a list of the categories of information that must be published. To give effect to the right of individuals to request and receive information, this type of legislation sets out clear procedures for the making and processing of such requests. It is recognized that some information held by public bodies should not be made public, such as personal information or sensitive security information. Access to information legislation describes in clear and narrow terms the information which must be protected (exceptions). Finally, better practice legislation also establishes an oversight body to which appeals from refusals by public bodies to provide information may be directed.

[66] As indicated in Annex 5 (on progress with implementation of the 2011 GO DPL reforms) there has been significant improvement in Access to Information since the approval of the Decree-Law in June 2011, but challenges remain. Indeed this reform supported by this GOJ DPL reflects the work done by the Bank to support the Government in the effective implementation of the 2011 Decree-Law. In addition the Bank has been working directly with CSOs to sensitize and stimulate the demand side for this reform, including by sponsoring the National CSOs Forum in May 2012, with more than 200 NGOs from across the country (which as part of the program included sessions on Access to Information and on the new Social Accountability mechanisms in Tunisia). The Bank will continue to work with Government to pursue demand-side actions, such as outreach to civil society and the private sector to disseminate the new Access to Information law.

and to deal with citizens' complaints. Effective access to information legislation is also a criterion for eligibility to the Open Government Partnership, which Tunisia aspires to join.[67]

123. *Expected results:* The Circular will enable the effective and large scale implementation of the 2011 Access to Information Decree-Law by providing the necessary instructions to officials. This will facilitate the proactive dissemination of information on the government's websites. The Circular also indicates clear procedures and forms for citizens who want to make requests for information and file complaints for failure to answer or unjustified refusal, which will also improve public information and confidence in this new policy of open and transparent governance. It is expected that thanks to the systems put in place as a result of the Circular at least 25 requests for information by citizens will have been granted by end-2014.

Prior Action #9: Strengthening budget and financial transparency

The Minister of Finance has issued Decision No. 278 ("*Note [concernant] la publication des données et informations relatives aux Finances Publiques*"), dated August 25, 2012, mandating the publication of key information on public finances, including a Citizen's Budget providing an online open budget platform which allows citizen's direct access to detailed and real time public expenditure data.

124. *Rationale:* In spite of recent initiatives and experiences following the revolution, the process of preparing the budget remains a relatively closed one, limiting the scope for an open and informed debate about priorities and budgetary decisions. The public is informed about budget priorities, once the budget law is adopted and published in the Official Journal. A first attempt at participatory approach was attempted in 2012 to program funds for regional development. In the absence of sufficient prior information and education, the results of this approach have been mixed and generated frustration among the public as well as the administration.

125. Similarly, the role of Parliament in the budget process was essentially limited to the voting of the draft budget of the executive within the constitutional deadlines. There was no debate on budget prospects early in the process of budget preparation. The review of the draft budget law gave rise to sessions of questions and answers, public plenary sessions, but was reflected only in rare amendments. The lack of publication of the draft budget also limits the opportunity for the public to monitor the preparation of the budget. The complexity of the budget documents makes that information inaccessible to a large portion of the population. The budget reports are produced but not always published. While Tunisia agreed with the International Monetary Fund Special Data Dissemination System, the Ministry of Finance has not had a pro-active communication of budgetary and financial information, including on its website. Furthermore, the absence of public disclosure of timely and detailed public expenditure data reduced the government's accountability and affected negatively the perception of economic operators.

126. *Reform measure:* The Minister of Finance has issued a Decision to strengthen fiscal transparency through the public disclosure of: (i) the budget circular, a medium term expenditure framework and a pre-Budget statement, including the macro-fiscal perspectives and assumptions underlying the budget, at the beginning of the budget process; (ii) the Government and Ministries budget proposal before transmission to Parliament; (iii) the monthly and year-end budget execution reports; (iv) a citizen's budget, i.e., a popularized version of the draft budget (starting from 2014 budget); and (v) the Budget Law settlement of year t-1 accompanying the draft budget of year t+1

[67] The Open Government Partnership is a new multilateral initiative that aims to secure concrete commitments from governments to promote transparency, empower citizens, fight corruption, and harness new technologies to strengthen governance. (For additional details visit: http://www.opengovpartnership.org). Tunisia has officially declared its intent to join the OGP at the Heads of State conference in Brasilia in April 2012. The OECD will carry out an assessment and the Bank is supporting Tunisia in meeting 2 of the 4 eligibility criteria: (i) on Access to Information, through the Decree-law and proposed mention in the constitution; and (ii) on fiscal transparency through the new ministerial Decision (see below).

(starting from 2014 budget); (vi) an online open budget platform giving citizens direct access to detailed and timely public expenditure data; and, (vii) performance objectives and reports for pilot ministries delivering key public services (Health, Education, Higher Education and Agriculture). The public disclosure of this information is intended to enhance budget and financial transparency. It is also a criterion for eligibility to the Open Government Partnership.

127. *Expected results:* The circular will result in regular publication of the draft budget and budget execution reports. The adoption of a proactive and formalized policy of information dissemination and a financial budget is a factor of public confidence in the government and allows a more informed and calmed debate about priorities and budgetary decisions. Prior diffusion of the budget preparation guidelines and fiscal outlook strengthens the Parliament role by giving it more time to prepare proposals for amendments to the government and more time to integrate them. Similarly, information for citizens, including through popularized documents, will enable them to better form and express their opinions either directly or through their representatives in Parliament.

VI. OPERATION IMPLEMENTATION

POVERTY AND SOCIAL IMPACTS

128. **The poverty and social impacts of the policies supported by the Governance, Opportunity and Jobs DPL are expected to be positive.** Many groups of stakeholders are likely to benefit from the policy measures supported by this program through several channels.

129. The measure on the **regulatory simplification** is expected to improve the business environment and increasing growth and employment in the medium term. Faster growth will lead to increased job creation, thereby supporting household incomes, with a positive impact on reducing poverty. Reducing regulatory procedures should have particularly positive impacts for women and unemployed youth, who face higher barriers to entering the labor force. It should be emphasized that the review exercise will focus on removing unnecessary regulations and reducing discretion in the application of existing rules, but will not remove the necessary health and environmental safeguards, as well as labor protection/standards. The highly participatory process will facilitate this outcome.

130. This is also the anticipated impact of **opening up access to the landing stations of international telecommunications cables to more operators**. In addition to the direct benefits in terms of consumer welfare arising from the reduction in the price of international telecommunications, this reform will improve the competitiveness of Tunisian companies, benefiting SMEs and large companies alike across the country, and also significantly increase the attractiveness of Tunisia as an offshoring destination. Regional decentralization of private businesses – such as Business Process Outsourcing (BPO) providers and call centers – is likely to disproportionately benefit female employment. Women in Tunisia are less likely than men to move for work, and among tertiary graduates unemployment rates are significantly higher for women in remote regions of the country

131. The measures on the **strengthening the stability in the banking sector** are not expected to have any negative poverty impact. On the contrary over the medium term they are expected to help Tunisia recover from the current economic crisis and therefore have an indirect positive economic impact on households and firms. The reforms will be introduced gradually to limit the risk that a credit crunch might exacerbate the current economic slowdown.

132. The **reform and rationalization of the programs financed by the National Employment Fund** is expected to benefit the unemployed by improving the quality and effectiveness of government programs and also to improve employability in the medium term.

133. The poverty and social impact of the **accreditation of health services** is expected to be positive, particularly for women. In Tunisia, 12 percent of households make high out-of-pocket payments, and the impoverishing effects of having to travel and pay premium for quality health

services and medications can be high and can lead to a loss of employment and income.[68] In 2008, nearly 1 in 5 lost their jobs in Tunisia due to ill health,[69] which can be alleviated to an extent with improved access to effective health services. Accreditation is expected to improve the quality of services in the medium term. Also, maternal mortality rates in western regions are nearly 30 percent higher than along the coast due in large part to poor quality of services and limited access, which is exacerbated by the limitations women face in traveling, especially in remote areas. In fact 70 percent of maternal deaths in Tunisia are due to avoidable reasons such as lack of medical equipment, medications and qualified personnel,[70] which can also be reduced with proper governance and regulatory mechanisms through accreditation. Similarly, the impact of the measures to improve the **quality of higher education** by establishing a National Authority for Evaluation, Quality-Assurance and Accreditation of higher education institutions is expected to be positive as they will lead to improved quality of these services.

134. Finally, the prior actions reinforcing the implementation of the June 2011 Decree-Law on **access to information** and introducing greater **transparency in the budget process and public finances** are expected to have positive social impacts and no negative poverty impacts. Over the medium term these reforms are expected to foster a better informed public debate on the efficiency and effectiveness of public services, and thereby contributing to improve the quality of service delivery and accelerate poverty reduction.

135. In sum, the specific policies supported by this DPL are not expected to have negative distributional and social impacts; positive impacts are likely expected as a result of increased citizen voice in the management of public life and the delivery of public services, and improved access to employment and social services, notably for young unemployed and women. Similarly, the poverty reduction impact of the policies supported by the DPL is expected to be positive, most notably the assistance to the unemployed and expanding frontline service delivery, both in the short and in the medium term.[71] The program's focus on extending market access and augmenting employment flexibility is anticipated to be particularly beneficial for women, given the specific mobility and time constraints they face.

ENVIRONMENTAL ASPECTS

136. **The institutional and policy framework is generally strong and well defined in Tunisia.** The Ministry of Environment and Sustainable Development is the key player in defining and implementing environmental policies and strategies. An annual report on the state of the environment is published yearly and action plans to address various environmental issues (incl. water, solid waste, biodiversity, natural resources, urban planning, etc.) are being implemented. The current five years development plan (2007-2011) allocates considerable investment for the protection of the environment. A policy note on the cost of waster degradation was prepared in 2007 and disseminated to all concerned sectors with clear recommendations for the optimization of the water resources, especially in the agriculture sector. Regarding water quality management, Tunisia continues its efforts for the establishment of a water quality monitoring network covering both surface and ground water.

[68] World Bank (2010). Who Pays? Out-of-pocket health spending and equity implications in the Middle East and North Africa. Discussion paper. Washington DC: World Bank.

[69] *Institute National de la Statistique*, (2008). Tunisia National Labor Force Survey 2008. Total sample size was 100,000. Among respondents who were employed but lost their jobs over the past six months, 16 percent, or nearly 1 in 5, cited "ill health" from among twelve possible choices (module 2, question 8).

[70] Dellagi RT, Belgacem I, Hamrouni M and Zouari B (2008). Évaluation du système de suivi des décès maternels dans les structures publiques de Tunis (1999-2004). *La Revue de Santé de la Méditerranée orientale*, 14 (6): 1380-1390.

[71] The extent to which these reforms translate into improved livelihoods for the poor and vulnerable groups may be difficult to measure directly, given the standard challenges faced in attempting to assign causality to individual policy changes. However, the fact that the Statistical Office (*Institute National de la Statistique*) has committed and started making available national survey datasets online (in particular the National Household Budget Surveys and the Labor Force Surveys) will facilitate ongoing monitoring of the labor market and welfare outcomes of the poor. Hence, as part of its poverty analytical work, the Bank team will monitor the impact of the reforms on economic growth on poverty reduction over time, notably on the extreme poor and other vulnerable groups.

In parallel, the Government initiated a new program to improve the environmental performance of wastewater treatment facilities. The national program on the reuse of treated wastewater, which is also among the priority of the new five year development plan, has been launched and several development and financial institutions are expected to join efforts with the Government for the implementation of the project. The Bank is working to help the Government to develop and implement appropriate policies in the areas of natural resources, environment and adaptation to climate change.

137. **Tunisia has a well established Environmental Impact Assessment (EIA) system.** In 2007 it has been selected to pilot the use of country system (UCS) in the solid waste sector. As a result of the successful implementation of this pilot, it has been decided to extend the scope of the use of the country system at the national level. All activities that may result in a significant impact on the environment are subject to an Environmental Impact Assessment, which has to precede the issuing of licenses and investment activity.

138. **The reforms supported in this DPL operation are not expected to have any positive or negative effects on the environment, forest and other natural resources.** The DPL supports policy actions that create the enabling environment to support poverty reduction, and which by themselves do not have an environmental impact.

139. The prior actions **granting the public access to information,** and to improve **transparency in the budget process and public finances** will have no negative environmental impacts and may in fact have a positive impact in term of environmental protection, as citizen and CSOs will have access to more information on government's investment programs and will be in a better position to raise any environmental concern they may have. The prior actions on **strengthening banking sector stability**, on the **reform of the programs National Employment Fund,** and the measures **introducing improving the quality of social services delivery** are also not expected to have any positive or negative effects on the environment, forest and other natural resources.

140. The reform to **open up access to the landing stations of international telecommunications cables to more operators** aims to accelerate economic development, but will not dilute the environmental standards for public works and investment projects, and therefore is expected to have no impacts. Similarly, the **regulatory simplification** will focus on removing unnecessary regulations and reducing discretion in the application of existing rules, but will not remove the necessary environmental safeguards (notably it will not affect the rigorous Environmental Impact Assessment framework that exists in Tunisia) and is therefore not expected to have negative environmental impacts. It is expected, however, that the regular private and public investment activities which may result from these last two policy actions, could have impacts on the environment. Nevertheless it is not expected that there will be need to introduce special measures since all activities to be carried out are subject to the Tunisian legal framework for the protection of the environment. Thus, neither specific environmental studies nor environmental impact management measures are anticipated.

IMPLEMENTATION, MONITORING, AND EVALUATION

141. **Implementation and coordination responsibilities:** The responsibility for implementing the program in Government rests with the Ministry of Investment and International Cooperation which will coordinate all relevant activities with other Ministries. The Government will take the lead in monitoring progress in implementation of this operation.

142. **Supervision by the Bank:** Regular supervision will allow the Bank to continue providing policy advice and technical assistance to the institutions involved in the implementation of the program of reform. The Bank will continue to maintain continuous dialogue with the relevant government ministries and will conduct regular reviews in close collaboration with other partners. This will take the form of joint missions with the AfDB and the EU and shared analytical underpinnings.

143. **Monitoring and Evaluation**: The monitoring and evaluation of the program and its expected results will be based on the government regular monitoring and evaluation (M&E) activities. The

Bank and other development partners will continue to provide support to the government to strengthen M&E, improve data quality and management and enhance capacity for using development outcomes to inform policy making.

FIDUCIARY ASPECTS

144. **The Public Finance Management system, together with the Government's commitment and plans to reform, are adequate to support this operation.** Public Finance Management in Tunisia is generally regarded as sound, transparent and well organized. The Tunisian system is based on the principle of segregation of responsibilities and separation of the roles between the payment authorizer (*ordonnateur*) and public accountant, and on the principles governing ex ante expenditure control and internal and external audits. The main weakness of the public financial management system was the lack of transparency and consultation in the process, notably in the preparation of the budget. This DPL is taking steps towards strengthening transparency and accountability in Public Finance Management (PFM) through to measures that will facilitate the creation of associations and allow public access to data and information—and which will allow greater scrutiny and debate of Government policies and the budget—as well through measures to strengthening transparency and accountability in the public procurement process. **The 2010 Public Expenditure and Financial Accountability assessment (PEFA) concluded that the legal and administrative framework for public financial management is sound and offers a solid level of assurance regarding the reliability of information and a strong control environment; however the report also identified transparency and accountability weaknesses.** The 2010 PEFA, undertaken jointly by the European Commission, AfDB and the Bank, assessed the period of 2006-2008. The PEFA report confirmed that the PFM system supports the achievement of aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. The report highlights that the main strengths of the Tunisian PFM system are: (i) credible and transparent budget;[72] (ii) strong and effective financial control procedures; (iii) effective internal audit function; (iii) reliable fiscal reporting; (iv) strong cash and debt management due notably to a technical assistance from the Bank. On the other hand, the report also highlighted several shortcomings, notably in the field of financial information and reporting, public procurement, the tax authority, internal and external financial controls. The main challenges of the PFM system are: (i) delays in the production of the year-end government financial statements; (ii) the need to shift for internal controls and internal auditing from compliance to a system rating the performance; (iii) the insufficient scope of the external audit which cover an average of 13 percent of expenditures; (iv) the need to accelerate the implementation of performance budgeting. In recent years the administration has continued to strengthen the PFM systems and introduced measures to: (i) move to a performance based budgeting framework; (ii) develop an Medium term Expenditure Framework (MTEF) to assist in fiscal sustainability; (iii) modernize its accounting framework; and, (iv) improve revenue management.

145. **The budget is generally executed in a straightforward way without any significant deviations, and fiscal reporting is deemed to be reliable.** [73] Reconciliations of banking and fiscal records are done satisfactorily on a monthly basis, facilitated by efficient computerization. Financial control is ensured by effective and reliable control systems—both internal and external, as well as ex-

[72] According to the 2004 Country Financial Accountability Assessment (CFAA) the documents that make up the budget law and its annexes are well prepared, easy to understand, and contain the relevant information. Most of the information requirements for budget documentation in the PEFA methodology have been met. The overview that introduces the budget law and the report on budget data provide good information. The economic and financial overview prepared by Ministry of Planning (termed the economic budget) is well written and illustrated with numerous macroeconomic tables in support of the assumptions on which the budget is based. A move to performance or results-based budgeting is underway.

[73] Every budget, regular and supplemental is published in the official journal upon approval, and it is also made available on the Ministry of Finance web portal (for instance the 2012 budget is available at the following link: http://www.portail.finances.gov.tn/jort/Loi%20de%20finances%202012.pdf and the 2012 supplementary budget is available at: http://www.iort.gov.tn/WD120AWP/WD120Awp.exe/CTX_4388-100-IFzhZCaUnQ/RechercheTexte/SYNC_-1553719828 and in fact all budgets since 2003 are on line). The government is committed to further expand the publication of information related to the budget and public finances, including a more accessible "Citizen's budget".

ante and ex-post. Financial controllers, who are part of the Directorate-General of Financial Control (DGDP), carry out the ex ante control of expenditure commitments and report to the Prime Minister's Office. The Court of Accounts carries out good quality external audit and the international standards on autonomy, scope and quality are met. The proposed budget and financial management reform program currently focuses on the implementation of sector MTEFs (which will be, in principle, framed by an aggregate Medium-Term Financial Framework (MTFF) and an MTEF that will frame the inter-sectoral resource allocation) and performance monitoring. It covers a range of PFM issues and includes a proposed training program, the implementation of a new budget classification, the finalization of the chart of accounts and the preparation of a new organic budget law.

146. **No safeguard assessment of the Central Bank has been conducted by the IMF (as there is no formal program with Tunisia); however, the Central Bank of Tunisia (CBT) is audited on a yearly basis with the audit report being disclosed publicly.** These audits and the auditor opinions did not reflect any weaknesses in the control environment and the auditor's opinions were issued with no qualifications. The Management Letter of the Central Bank revealed some internal control issues related to the foreign exchange management. The CBT agreed to take appropriate remedial actions and these weaknesses have since been addressed.

DISBURSEMENT AND AUDITING

147. **The proposed loan will follow the Bank's disbursement procedures for development policy support and will be disbursed in a single-tranche.** After the loan has been approved by the World Bank's Board of Executive Directors and becomes effective, the proceeds of the loan will be disbursed in compliance with the stipulated release conditions as defined in the Development Loan Agreement and in a single installment, namely that disbursements will be made provided the (i) Bank is satisfied with the program being carried out by the Borrower and (ii) with the appropriateness of the Borrower's macroeconomic policy framework Once the loan is approved and becomes effective, and provided the Bank is satisfied with the program being carried out, the proceeds of the loan will be deposited by IBRD in a dedicated account designated by the Borrower and acceptable to the World Bank at the Central Bank of Tunisia at the request of the Borrower, upon submission of a signed withdrawal application. The Borrower should ensure that upon the deposit of the loan proceeds into said account, an equivalent amount in local currency is credited in the Treasury current account at the Central Bank. The conversion will be based on the prevailing exchange rate on the date that the funds are credited to the Treasury Account.

148. **The Borrower will report to the Bank on the amounts deposited in the foreign currency account and credited to the budget management system.** If the proceeds of the loan are used for ineligible purposes as defined in the DPL Loan Agreement, IBRD will require the Borrower to promptly upon notice refund an amount equal to the amount of said payment to IBRD. Amounts refunded to the Bank upon such request shall be cancelled. The loan proceeds will be administered by the Ministry of Finance. The flow of funds (including foreign currency exchange) is subject to standard public financial processes. The Government budget is comprehensive, unified and subject to centralized treasury account. The Government of Tunisia will provide a written confirmation to IBRD within thirty days of disbursements. The confirmation will include the local currency amount credited to account that is used to finance budgeted expenditures, the exchange rate applied and the date of the transfer.

149. **Although an audit of the use of the funds may not be required, IBRD reserves the right to ask for a transaction audit.** This audit, when asked for, will cover the accuracy of the transactions of the dedicated account, including accuracy of exchange rate conversions; confirming that the dedicated account was used only for the purposes of the operation where no other amounts have been deposited into the account. Also the auditor will have to obtain confirmation from corresponding bank(s) involved in the funds flow regarding the transaction. The time period for submission of the audit report to the Bank is 6 months from the date a request for such audit is issued.

RISKS AND RISK MITIGATION

150. The risks to this operation relate to: (i) renewed political instability from unmet or conflicting political aspirations; (ii) uncertainty of the economic outlook; (iii) risks to the stability of the financial sector; and (iv) risks related to the design and implementation of the program of reform measures. Details for each of these areas are provided below:

(i) Risks related to renewed political instability from unmet or conflicting political aspirations

151. **The main short term risk facing Tunisia is related to the resurgence of social tensions which could result in political instability.** While the successful outcome of the October elections and the arrival of the moderate Islamist/center-left coalition Government brought some stability to Tunisia, the new Government has been confronted by growing social tensions in early 2012. On the one hand, the growing activism of Salafis calling for Islamic law and confrontations with secularists, and on the other, a rash of strikes and sit-ins that continued to disrupt economic activity in some key sectors. Although protests and strikes abated since February, there are concerns that these could return and escalate unless there are visible improvements in the economy. Further, there have been repeated attempts at putting in discussion the status of women and their role in the economic and social life, and the positive record of Tunisia will need to be carefully safeguarded. Also, while the political situation appears to have stabilized, nevertheless there is a risk that the political climate may become unstable again in the run-up to the elections. In such a case, this could hamper the Government's ability to push through the reforms and further delay investors returning to Tunisia. The adoption and implementation of the Government's 2012 program and budget law in May has provided some assurances of the Government's priorities, particularly to respond to needs of lagging regions and social programs. The political, financial and policy support from international community may help mitigate these risks. The timing of the elections and the way the process is managed will also be critical.

(ii) Risks related to the uncertainty of the economic outlook

152. **The external environment represents additional risks for the country's economic performance.** In addition to the domestic social tensions and security problems, uncertainty about the economic outlook related to the impact of the Eurozone crisis, the stabilization process in Libya, and the recent increase in international food and fuel prices, poses significant risk to economic and political developments in Tunisia. Notably the economic downturn in Europe will affect Tunisia's export performance and FDI inflows, since the EU market represents about 75 percent of Tunisian exports. Lower economic growth and additional pressure in the labor market could lead to renewed social tensions and reinforce a sense of lack of economic opportunity. A recurrence of instability might lead to a renewed loss of foreign investors' confidence, which will in turn affect industrial production and exports, further depressing domestic consumption and slowing the economic recovery, and sending Tunisia into a negative spiral. In order to mitigate these risks the authorities have adopted a supplementary budget to boost economic growth by accelerating public investments, notably in the lagging regions, and to scale up social interventions, and support enterprises during this transition. The measures supported by this operation also aim to both facilitate public and private investments, introduce reforms to progressively improve the quality and provision of social services, and to help reestablish social stability by consolidating the progress in giving greater voice and accountability by the population. The authorities will also continue to pursue flexible budgetary and monetary policies to support economic recovery in an international environment which remains uncertain and volatile. In addition, while the macroeconomic situation is presently stable and the authorities have not requested IMF financing, should the macroeconomic situation deteriorate substantially, the authorities stand ready to request additional support through an IMF program.

153. **An additional risk is linked to the effectiveness of the fiscal stimulus on the economy.** The economic projections presented here assume a strong impact of the fiscal stimulus on the economy, and its rapid and almost complete implementation during the year 2012. This might not be possible if there is not enough financing to support the package, if the procedures are too lengthy, or if there are

difficulties in the implementation of the plan itself. In these scenarios, the support package might not have the full effect on the economic recovery that has been envisaged by the Government and could lead to lower economic growth. The resulting additional pressure in the labor market could lead to renewed social tensions. In order to mitigate the risks mentioned above the authorities have launched a multipronged effort to identify and remove bottlenecks to investment budget execution (by removing bottlenecks in public procurement procedures, and tackling issues related to access to land and local level cofinancing for public investment projects), and thereby maximize the efficacy of the public fiscal stimulus.

(iii) Risks to the stability of the financial sector

154. **Tunisia's banking sector remains in a precarious situation.** In order to address weaknesses in the financial system, over the past few years the authorities have been pushing banks to (a) steadily increase the provisioning rates, (b) decrease NPLs, and (c) implement strong internal control regulation, while keeping active supervision of the banking sector. The negative shock on the tourism sector (both from the revolution and the Libyan crisis) and the sensitivity of the exporting sectors to growth variations in Europe both translate into higher credit risk in the banking sector. Notably, the banking system is exposed to the tourism sector (at 12.7 percent of total loans in 2009). These risks will be added to the already relatively weak asset quality of the banking sector. The Central Bank provided liquidity support to banks in 2011 which allowed credit growth to continue at 15 percent for the year and prevented bankruptcies. However, with less room for monetary easing in 2012, there is a risk that the banking system will start to tighten credit, making it difficult for businesses to operate and dampening the economic recovery. The Bank fielded a mission in April 2011 to work with the authorities in assessing the stability of the financial sector, including full-fledged stress test by bank and a discussion of the crisis preparedness arrangement. In January 2012 an FSAP mission, jointly with the IMF, carried out an in depth assessment of the health of the financial sector and identified a program of reforms to improve the capacity of the financial sector and strengthen its resilience to economic shocks. The risk to the financial sector at this point will stem from inaction on the part of the authorities. The measures supported by this DPL arise from this FSAP.

(iv) Risks related to the design and implementation of the program

155. **The strong political and economic interests at stake during the political transition could pose challenges to the pursuit of the reform program.** While the Constitutional Assembly Government has been elected in a general election and has full popular legitimacy, some key stakeholders may deem it inappropriate to address politically sensitive issues before a new government is elected under the new Constitution. Secondly, there may be bureaucratic resistance. Finally, risks also exist that the new post-elections government could reverse the reform agenda, in particular against pro-business policies. The risks of reversal are mitigated by the process of negotiation of the Deep and Comprehensive Free Trade Area (DCFTA) agreement with the EU, as the underlying objective of closer integration with the EU can serve as an anchor to ensure that the reform program continues over the medium term. The Bank is supporting the DCFTA process by providing technical assistance on trade integration options to the government. More generally all the above risks can be mitigated by consensus building both within and outside of the current Government. The Bank's technical assistance and informal discussions with civil society and key stakeholders during the preparation of this operation should mitigate these risks. Also the program supports reforms that have been identified previous studies and/or are challenges which are well known, and there is broad agreement that these issues constitute bottlenecks in the economy and therefore job creation. That said, there is a risk that the government will not push forward with difficult reforms if they prove unpopular or may give rise to any social disruptions, particularly given the Government's short mandate. The Bank should have realistic expectations of what can be achieved during the transition based an open dialogue with government, civil society and other partners. Hence, the Bank is working with the Government to have wide debate on the various reforms, and ensure a broad consensus before the adoption of the reforms. The participatory process and communication campaign accompanying

the reforms should be focused on the message of job creation and leveling the playing field, which is at the core of the priorities in post-revolution Tunisia.

ANNEXES

ANNEX 1: LETTER OF DEVELOPMENT POLICY

République Tunisienne

Le 09 octobre 2012

Monsieur Jim Yong Kim
Président du groupe de la Banque Mondiale
Washington, DC

Lettre de politique de développement

Monsieur le Président,

La Tunisie s'apprête à entrer dans une nouvelle phase du processus de transition historique marqué par la révolution populaire du 14 janvier 2011, après avoir passé avec succès l'étape des élections de l'Assemblée Nationale Constituante et la formation d'un nouveau Gouvernement, devant permettre de rétablir la légitimité des institutions, une fois la nouvelle constitution adoptée et de nouvelles élections nationales et locales organisées.

Le principal défi pour la Tunisie consiste à assurer la stabilité économique et sociale compte tenu des perspectives défavorables au niveau régional et international (persistance de la crise dans l'Union européenne et l'instabilité de la situation en Libye).

La Tunisie vit en effet une période de transformation inédite qui engendre de nouveaux défis et opportunités pour l'économie du pays. L'impératif réside dans la nécessité de rétablir un rythme de croissance économique, après la contraction sans précédent de l'ordre de 2% en 2011, et l'exigence d'apaiser les tensions sociales, de favoriser la création d'emplois et de réduire les disparités régionales en répondant aux besoins pressants des régions défavorisées du pays.

Dans ce contexte, l'action de développement engagé par la Tunisie depuis 2011 se singularise par son caractère d'urgence et sa dimension stratégique : le gouvernement doit en effet répondre à un enjeu de relance de court terme tout en préservant la stabilité macroéconomique du pays à moyen terme, et lancer un processus de réformes structurelles permettant d'instaurer les bases d'un nouveau modèle de développement. C'est la condition fondamentale au succès de la transition démocratique du pays.

1. Cadrage et stratégie macroéconomiques

Sur le plan économique, la priorité depuis le début de la transition politique a été accordée à la relance des activités économiques ainsi qu'au rétablissement du climat de confiance pour dynamiser les investissements nationaux et étrangers. Après une contraction du PIB de -2.2% en 2011, le début de l'année 2012 a été marqué par des signes prometteurs de reprise économique. Néanmoins, les effets de la crise de la zone euro ainsi que la hausse des prix des produits de base ont commencé à

affecter l'économie tunisienne depuis le deuxième trimestre 2012. Bien que la croissance du PIB ait enregistré une moyenne de 3.3% au cours du premier semestre, elle a été moins vigoureuse pendant le deuxième trimestre (2.1% contre 4.6% au premier trimestre). Alors que le secteur agricole et le secteur touristique ont enregistré une bonne performance, les secteurs des industries manufacturières exportatrices, notamment le textile et les industries mécaniques et électriques, ont accusé une contraction de leurs activités au cours du deuxième trimestre 2012, respectivement de -8.6% et de -8.2%. De l'objectif de 3.5% de croissance pour l'année 2012, le Gouvernement compte ramener le niveau de croissance à un palier supérieur compatible avec la réduction du chômage, à 4.5% en 2013, puis à 5.2% et à 6.3% en 2014 et 2015 respectivement.

Parallèlement, la hausse des prix des commodités a été à l'origine des pressions inflationnistes depuis la fin de l'année 2011. L'inflation a atteint 5.5% en glissement annuel en septembre 2012, contre 3.3% une année auparavant. La Banque centrale a, depuis la révolution, continué à soutenir l'économie à travers des injections massives de liquidité et la baisse des taux d'intérêt et de réserve obligatoire. Afin de faire face à l'inflation, les autorités monétaires ont augmenté le taux d'intérêt de 3.5% à 3.75% en fin août 2012. L'inflation devrait rester au niveau de 5.5% en 2012, puis progressivement ralentir, de 4.8% en 2013 à 4.3% en 2015.

Les exportations sévèrement affectées en 2011 à savoir le tourisme, le transport, le phosphate et l'énergie ont bénéficié de la reprise, avec notamment un accroissement des recettes touristiques de 40% durant les huit premiers mois de 2012. Alors que la plupart des secteurs ont ainsi amorcé la reprise, le secteur manufacturier exportateur a progressivement été affecté par la récession économique de la zone euro, en particulier depuis le deuxième trimestre 2012. Par ailleurs, la hausse des importations a été renforcée par l'accroissement des prix des produits pétroliers et alimentaires, combinée à la dépréciation du dinar. Le déficit commercial a ainsi accusé un élargissement de plus de 50% durant les huit premiers mois. Le déficit du compte courant, qui a déjà atteint 7.3% en 2011, un niveau historiquement très élevé pour la Tunisie, a atteint 5.6% du PIB à fin août 2012 (contre 3.9% un an plus tôt). Ceci s'est traduit par la réduction du niveau des réserves extérieures à 9.8 millions de dinars (96 jours d'importation) en fin septembre 2012, contre 10.5 millions de dinars (113 jours d'importation) un an plus tôt. Le Gouvernement compte progressivement ramener le niveau du déficit du compte courant à un niveau plus soutenable, de 7.4% en 2012 à 5.4% en 2015, notamment à travers la dynamisation du secteur exportateur. En s'appuyant sur la reprise de l'économie européenne, la croissance réelle de l'exportation des biens et des services devrait atteindre un rythme soutenu, 6.1% dès 2013, pour atteindre 8.1% en 2015.

Sur le plan budgétaire, la loi de finances complémentaire de 2012 adoptée en mai 2012 prévoit des mesures importantes de relance et de stabilisation sociale avec un accroissement des dépenses de 22%. Cette hausse de dépenses prévues par le budget 2012 s'explique par des augmentations de 17% des dépenses courantes et de 30% des dépenses de développement. La bonne performance des recettes fiscales et non-fiscales avec l'apport de financements exceptionnels tels que l'utilisation des revenus de privatisations et de la vente des biens mal-acquis, permettra de respecter le niveau du déficit budgétaire à 6.6% du PIB (contre 3.5% en 2011) conformément à la loi des finances complémentaire 2012. Le Gouvernement a initié des mesures pour maîtriser le niveau des subventions qui est devenu insoutenable. En effet, pour faire face à la demande sociale et à la hausse des prix des produits alimentaires et hydrocarbures, le montant accordé aux subventions en 2012 a largement dépassé celui initialement prévu, pour atteindre 6% du PIB. Dès septembre 2012, le

Gouvernement a ajusté à la hausse le prix du carburant. En 2013, le Gouvernement compte initier la réforme du système de compensation afin de mieux cibler les bénéficiaires et de maîtriser les dépenses de subventions. De même, la réforme de la caisse de retraite devrait être introduite dès 2013 pour améliorer sa soutenabilité compte tenu de l'évolution démographique de la Tunisie. A moyen terme, le Gouvernement compte engager des réformes importantes pour une gestion efficiente et soutenable des finances publiques, y compris dans les domaines de la recapitalisation des banques publiques et des arriérés auprès des entreprises publiques. Les efforts seront également consacrés à une meilleure maîtrise de la masse salariale. Ces réformes contribueront à ramener le niveau du déficit à un niveau plus soutenable de manière graduelle, de 5.9% du PIB en 2013 à 4.1% en 2015, avec la priorité accordée à l'inclusion sociale et la relance de l'économie. De même, le niveau de la dette publique devrait être maîtrisé à moyen terme, tout en tolérant une hausse temporaire de 46% à 48% de 2012 à 2014.

Il est projeté que les besoins de financements extérieurs resteront à un niveau élevé durant les années à venir, avec une réduction graduelle, de 7967 millions de dinars en 2012 à 7695 millions de dinars en 2015. Le niveau des réserves devrait être maintenu à environ 110 jours d'importation pendant la période. Afin de faire face aux défis de la transition démocratique, dont les conséquences économiques ont été aggravées par les chocs exogènes, l'apport des partenaires au développement sera crucial d'une part pour appuyer les réformes du Gouvernement et d'autre part pour mobiliser les ressources de financement nécessaires durant cette phase historique de la Tunisie.

2. Stratégie de développement du gouvernement

Conscient de la nécessité d'approfondir la teneur des réformes structurelles et l'accélération de leur rythme pour consolider la reprise de l'activité économique, le Gouvernement a élaboré en articulation avec le plan d'action d'urgence, une stratégie de développement incluant une nouvelle vision pour l'avenir de la Tunisie et prônant un nouveau projet de société qui se veut global, inclusif et équilibré.

Cette stratégie prévoit un ensemble de réformes structurelles sur le moyen et le long terme visant à créer les conditions d'une accélération de la croissance et de la création d'emploi dans un souci d'équilibre régional et de développement inclusif. Elle est articulée autour de 5 piliers : les réformes économiques et sociales ; la modernisation des infrastructures ; le rééquilibrage régional ; le renforcement des secteurs sociaux, d'éducation et d'emploi ; et la promotion d'un développement durable tenant compte des ressources naturelles.

Les réformes économiques et sociales

Il s'agit de mettre en place les conditions d'une gouvernance plus transparente et efficace, améliorer la gestion des finances publiques, renforcer le climat des affaires et favoriser ainsi investissements et partenariats internationaux.

L'amélioration de l'environnement des affaires devra inclure le renforcement de la concurrence sur le marché intérieur, la réduction des obstacles réglementaires et l'amélioration des interventions des structures publiques de soutien et d'encadrement et le développement du partenariat entre les secteurs public et privé. Les réformes portent également sur la révision du code des incitations à

l'investissement pour plus de transparence, de facilitation et de liberté d'entreprendre ainsi que la révision des systèmes fiscal et douanier.

Les réformes économiques s'inscriront dans un processus d'approfondissement de la **libéralisation extérieure**. L'ouverture de la Tunisie sur l'extérieur est un choix stratégique pour la Tunisie afin d'accroitre le rythme de croissance, de créer de nouveaux postes d'emploi, d'assurer le transfert de la technologie, et de drainer le financement approprié au développement. Le processus de libéralisation sera consolidé à travers l'approfondissement de la coopération avec l'Union européenne pour un partenariat privilégié.

Le secteur financier sera également l'objet d'efforts de rationalisation. Le processus de libéralisation des mouvements de capitaux sera poursuivi graduellement afin de garantir les ressources de financement extérieur nécessaires pour l'économie nationale et favoriser l'attraction des investissements directs étrangers dans tous les secteurs de l'économie. Les principales actions porteront sur le renforcement de l'efficacité de l'intermédiation bancaire à travers l'assainissement des portefeuilles des banques, la consolidation de leurs capacités financières et techniques, la modernisation de leurs modes de gestion et de gouvernance ainsi que la diversification des prestations bancaires à l'instar de la finance islamique. Les réformes portent également sur les secteurs de la micro-finance, de l'investissement en capital et du marché financier.

La modernisation des infrastructures

L'intégration de l'économie tunisienne avec l'économie globale, et en particulier l'Union Européenne et la région du Maghreb, de même que l'amélioration du climat des affaires, et un meilleur équilibre de développement des régions, exigent une amélioration et une modernisation des infrastructures, en particulier logistiques (port en eau profonde, réseau de transport ferroviaire et d'énergie, ...)

La modernisation de l'infrastructure de télécommunications sera axée sur l'élargissement du taux de couverture et des capacités de connexion, l'amendement du cadre réglementaire et la réorganisation du secteur d'internet et l'optimisation de la gestion des espaces technologiques et virtuels.

Le rééquilibrage régional

Une meilleure répartition des richesses et des potentiels de croissance entre les différentes régions de la Tunisie est essentielle, les déséquilibres étant une des sources de la révolution. Ce rééquilibrage passe par des efforts non seulement au niveau de la gouvernance, avec un processus de décentralisation/déconcentration, mais aussi au niveau des infrastructures physiques (routes, eau, assainissement, énergie), de l'investissement en matière de capital humain (éducation, enseignement supérieur, santé), et de l'amélioration des télécommunications.

La réduction des disparités entre les régions sera favorisée grâce à une répartition équitable des investissements publics selon des critères objectifs, outre l'élaboration des programmes de développement régionaux adaptés aux spécificités et aux ressources propres de chaque région et l'amélioration de l'efficacité des programmes de développement intégré.

Les actions de réformes prévoient également l'encouragement à l'implantation des investissements productifs dans les régions intérieures et la valorisation de leurs avantages comparatifs. Un effort particulier sera déployé pour la modernisation de l'infrastructure dans les zones rurales et la généralisation des équipements collectifs à toutes les régions du pays pour améliorer les conditions de vie et répondre aux besoins de la nouvelle dynamique régionale.

Le renforcement de secteurs sociaux, d'éducation et de l'emploi

Le gouvernement se concentrera sur les secteurs sociaux et l'éducation, depuis le renforcement de la qualité et de la gouvernance de ces dispositifs, jusqu'à leur modernisation conformément aux bonnes pratiques et aux standards internationaux. Pour l'éducation, l'objectif est de parvenir à un dispositif d'enseignement (éducation de base / formation professionnelle / enseignement supérieur) qui soit adapté à l'évolution démographique du pays et permette de soutenir le développement de secteurs à plus forte valeur ajoutée et la compétitivité des entreprises.

L'amélioration de la qualité et de l'efficacité de ces secteurs passe en particulier par une plus grande autonomisation des structures et un accent renforcé sur la qualité des services rendus.

De même, le gouvernement poursuivra la refonte de la politique active de l'emploi et l'encouragement au travail indépendant et la réforme des systèmes de sécurité sociale.

La promotion d'un développement durable tenant compte des ressources naturelles du pays

Il s'agit à la fois de préserver les écosystèmes, notamment marins, et lutter contre la désertification ; renforcer la lutte contre la pollution, qu'elle soit hydrique à travers les programme d'assainissement, solide ou atmosphérique ; accentuer les efforts d'efficacité énergétique et de développement des énergies renouvelables.

3. Les réformes spécifiques engagées en 2012

Pour la mise en œuvre des actions et programmes contenus dans cette stratégie, le Gouvernement s'attèle à la concrétisation des actions adoptées dans le premier programme d'appui à la relance en 2011, et se focalise sur l'élaboration d'un programme de réformes ambitieux pour 2012. La liste des réformes et engagements du gouvernement a été mise en ligne sous la forme d'une matrice, sur le site internet du gouvernement tunisien :

(http://www.tunisie.gov.tn/index.php?option=com_content&task=view&id=1883&Itemid=518&lang=french).

Ce programme de réformes, mené en parallèle de l'effort à court terme de relance budgétaire, s'articule autour de trois grands objectifs de politique publique : la croissance et la création d'emploi; le développement régional et la protection sociale; la bonne gouvernance.

Premier axe : Croissance et création d'emploi

Climat des affaires et compétitivité

Le programme de réformes est en articulation avec la relance budgétaire qui est en partie fondée sur les investissements publics. Une première action concerne ainsi l'accélération de la mise en œuvre des programmes d'investissement. En effet, les processus de passation des marchés publics ont toujours été caractérisés par une grande lourdeur dans les procédures et la mise en œuvre. Le gouvernement a donc lancé un **processus de simplification et de clarification du processus des marchés publics et a adopté des mesures pour accélérer l'exécution du budget d'investissement.** Elles se traduisent par l'adoption d'un décret relatif à la réglementation des marchés publics d'une

part et l'adoption d'une Circulaire du Chef de Gouvernement concernant la réduction des délais et les procédures d'usage pour la mise à disposition des crédits d'engagement des projets d'investissement publics en 2012, d'autre part. De la même manière, le gouvernement a procédé à une synthèse des engagements en matière d'investissements publics par secteurs d'activité et par gouvernorat, afin de donner une plus grande visibilité et de responsabiliser l'ensemble des parties prenantes.

Le gouvernement s'attache également **à améliorer l'environnement des affaires**, qui était jusqu'à la révolution marqué par un manque de transparence et la permanence de situations anti-concurrentielles. Il s'agit donc de réduire les contraintes et les autorisations administratives, limiter les possibilités de décision de nature discrétionnaires, renforcer la transparence des procédures liées aux investissements et réduire les situations de monopoles ou d'oligopoles.

Le Chef du Gouvernement a ainsi adopté un décret lançant une **réforme visant à simplifier les formalités administratives dans le domaine de l'environnement des affaires** (dans tous les domaines liés à l'investissement et l'activité du secteur privé) et réduire le pouvoir discrétionnaire des cadres administratifs dans leur application.

Cette décision est la première étape d'une revue en profondeur de la réglementation qui passera notamment par la **révision du code d'incitations aux investissements afin de l'aligner aux standards internationaux.** Cette révision, qui constituera une révision complète de la loi, aura en particulier pour objectif de rationaliser les incitations fiscales et non fiscales et de réduire les disparités entre secteur « off-shore » et « on-shore » de l'économie.

Afin de favoriser et augmenter les investissements locaux et internationaux, le gouvernement souhaite favoriser **le développement des partenariats public-privé,** qui permettront d'améliorer la qualité et la diversité des services, tout en allégeant le coût pour l'Etat. Une évolution de la réglementation est pour cela nécessaire, afin d'élargir les modalités de PPP, aujourd'hui limités aux concessions. **Une nouvelle loi sur les PPP et une harmonisation des décrets d'application sera nécessaire.**

Le programme de réforme prévoit également des actions permettant de réformer les conditions de concurrence entre les acteurs économiques. En effet, de **nombreux** secteurs d'activité sont trop réglementés ce qui représente un frein important à l'investissement. De ce fait, le gouvernement s'engage à **réformer la loi sur la concurrence** dans le but de réduire son application discrétionnaire et d'augmenter la transparence de l'action du Conseil de la Concurrence. Le renforcement de la concurrence passera également **par l'extension des autorisations automatiques de franchises étrangères**, en particulier dans les secteurs de l'alimentation.

Le retour de la croissance pourra être accéléré en renforçant la concurrence dans des secteurs particuliers qui, dans le contexte actuel, impactent négativement la compétitivité de l'économie tunisienne. Il s'agit en particulier du secteur des **télécommunications** et du **transport aérien.**

Dans le secteur des **télécommunications**, à l'exception de la téléphonie mobile, la faible concurrence entre les acteurs sur le segment des échanges de données et des télécommunications internationales rend les niveaux de prix très élevés. De même, les infrastructures dans l'intérieur du pays ne sont pas utilisées de manière optimale. **Des mesures devront être prises rapidement, visant à ouvrir l'accès aux stations d'atterrissement des télécommunications internationales de Tunisie Telecom**. Le rôle de l'ATI sera également revu**. Les opérateurs d'infrastructures alternatives (STEG, SNCFT, ...)**

pourront louer leur capacité excédentaire et offrir une connectivité transfrontalière. De nouvelles licences internationales seront accordées. Enfin l'INT agira pour imposer une réduction progressive et significative des coûts de tarification internationale des échanges Internet et des appels internationaux. Enfin, le gouvernement clarifiera les rôles et responsabilités des différents acteurs, en particulier l'Instance Nationale des Télécommunication et l'ATI.

Dans le secteur du **transport aérien**, le système restrictif de licences limite ainsi le potentiel touristique du pays en renchérissant les coûts de transports. La libéralisation du secteur des transports est ainsi un enjeu de compétitivité important, et s'inscrit en particulier dans la stratégie Tourisme 2016 que le gouvernement a adopté. Le gouvernement souhaite donc s'orienter vers une ouverture de son espace aérien et lancera **des négociations pour un rapprochement réglementaire avec l'acquis communautaire, vers l'accord « Open Skies » avec l'Union Européenne**.

A travers cet ensemble d'actions, le gouvernement entend créer des conditions favorables à l'investissement privé et à la croissance. Cependant, dans un contexte de récession économique et d'environnement international déprimé, des secteurs doivent être accompagnés dans un processus de sortie de crise.

L'économie tunisienne est avant tout **une économie de PME**. Un grand nombre de ces dernières ont été fortement touchées par la crise et un effort de restructuration est indispensable. Améliorer l'environnement des affaires nécessite ainsi **une réforme de la réglementation relative aux entreprises en difficulté**, qui permettra de faciliter leur restructuration, alléger le poids des créances accrochées et libérer des marges de financement pour les entreprises saines.

Le secteur du **tourisme**, qui concentre une grande partie des prêts non performant des banques, doit être traité de manière spécifique et avec un fort engagement de l'Etat, des banques et des professionnels du secteur. En effet la crise structurelle que subit ce secteur depuis plusieurs années a été aggravée par les suites de la révolution. Les unités hôtelières les moins rentables, en restant en activité, détériorent l'image du secteur et affaiblissent sa compétitivité, en plus de fragiliser le secteur bancaire. Le gouvernement s'apprête, pour traiter la question du secteur, **à créer une « Asset Management Company » d'ici la fin 2012** qui aura la charge de restructurer les unités non viables.

Secteur financier

Le retour d'une croissance soutenue nécessite également la présence **d'un secteur financier stabilisé, assaini et diversifié**. Le gouvernement poursuivra donc son action dans ce sens, sur la base des réformes engagées à partir de 2011 au niveau du secteur bancaire, de la diversification des outils de financement (marchés, caisse des dépôts et consignation), et du développement de la microfinance et du capital investissement. Les actions prévues dans le domaine financier vont permettre de consolider la situation financière des banques publiques, affiner l'analyse des risques, assurer la stabilité financière, développer le cadre réglementaire et améliorer le fonctionnement des marchés de capitaux conformément aux meilleurs pratiques et standards internationaux.

Le premier enjeu est la **stabilité du secteur bancaire**, dont les problèmes dépassent le simple secteur du tourisme. En effet, en raison d'une gouvernance faible et sujette à de nombreuses pressions politiques, le secteur, en particulier les banques publiques, a accumulé d'importants stocks de prêts non performants, avec des taux de provisionnement trop faibles. Des actions importantes doivent être prises afin qu'il puisse à nouveau jouer le rôle qui lui est imparti dans le financement du

développement et de la croissance. Les banques publiques sont particulièrement concernées. Des premières étapes ont été franchies en 2011, avec la mise en place de stress tests par la Banque Centrale et l'évolution des règles de gouvernance. Le gouvernement poursuivra son effort, en coordination avec la Banque Centrale.

A travers le **lancement de trois audits stratégiques pour la STB, la BH et la BNA** dont l'appel à intérêt a été publié, le gouvernement entend lancer un vaste processus de restructuration du secteur public bancaire, incluant leur recapitalisation. D'ores et déjà, il a décidé et autorisé **une première recapitalisation de la STB afin de permettre à cette dernière de respecter son ratio de solvabilité de 8% à décembre 2012**.

La stabilité financière doit être renforcée et les règles prudentielles progressivement évoluer vers des standards internationaux. C'est dans ce sens que la Banque Centrale a **renforcé des aspects clé de la règlementation prudentielle**.

Parallèlement au renforcement de la stabilité du secteur, les outils de financement de l'économie doivent être diversifiés, depuis le financement des TPE, jusqu'à l'accès au marché des capitaux :

- Le secteur de la **microfinance** continuera ainsi d'être promu à travers la mise en place effective du cadre réglementaire indispensable (adoption des décrets d'application de la loi sur la micro-finance permettant de déterminer les modalités d'agrément et établissement d'une autorité de régulation).
- **L'investissement en capital**, particulièrement utile pour soutenir les entreprises dans leur croissance et leur évolution, verre également son cadre réglementaire enrichi par l'adoption et la publication des décrets d'application de la loi de 2011 sur le capital investissement.
- Enfin, le gouvernement souhaite donner plus d'importance au **marché des capitaux,** en favorisant l'émergence d'un marché secondaire. C'est dans ce sens que des actions seront prises pour faciliter l'émergence d'une véritable courbe des taux, en permettant à de nouveaux acteurs d'intervenir.

Marché du travail, programmes d'emploi à court terme et enseignement supérieur

L'emploi représente le défi majeur en Tunisie. Il ne peut être totalement résolu que sur le moyen terme et nécessite un ensemble de **réformes structurelles**, en complément du soutien au secteur privé, le seul à même de créer les postes d'emploi à fort contenu en valeur ajoutée nécessaires pour absorber les diplômés de l'enseignement supérieur, et en particulier les femmes. En sus du soutien au secteur privé, la **réduction des entraves au marché du travail doit être renforcée**.

Le gouvernement a donc lancé un dialogue national avec les partenaires sociaux (UTICA, UGTT) dans l'objectif **d'aboutir à la signature, en janvier 2013, d'un nouveau contrat social** pour le pays, qui sera une première étape vers une réforme du code du travail (relations professionnelles, travail décent, politiques d'emploi et de formation professionnelle ; couverture sociale et les politiques de revenus; négociations collectives et les politiques de développement régional).

Les réformes du marché de travail visent à renforcer l'efficacité de la politique active de l'emploi en termes d'amélioration de la stabilité et de la qualité des emplois créés pour les jeunes, d'attractivité de l'emploi, de supervision de la performance des programmes d'emploi, et d'amélioration de la

capacité des services d'emploi liés au temps de recherche de travail et à la satisfaction des offres d'emploi. Elles s'articulent en particulier autour de :

- La révision du décret 349-2009 fixant les programmes du Fonds National de l'Emploi (Fonds 21/21), en vue de **consolider et améliorer l'efficacité et la gouvernance des Politiques Actives de l'Emploi (PAE)** avec notamment la consolidation des programmes d'insertion et la mise en place d'un cadre institutionnel et juridique de suivi et d'évaluation des PAE. Parallèlement, le gouvernement prépare une **réorganisation de l'ANETI**.
- L'adoption de mesures relatives à la flexibilité des horaires de travail dans la fonction publique, permettant en particulier de faciliter la participation des femmes au marché du travail. La **réglementation de la fonction publique au titre de la durée du travail a ainsi été modifiée, intégrant des horaires flexibles ; la mise en place de** la semaine de 5 jours. En Parallèle, le gouvernement étudie les possibilités de réforme permettant de préserver et renforcer la place des femmes dans la vie économique et sociale de la Tunisie (par exemple l'harmonisation des réglementations publiques et privées relatives **au congé de maternité)**.

Le gouvernement souhaite également insister sur la nécessité de renforcer la qualité du dispositif d'enseignement supérieur. Première étape vers une plus grande autonomie des établissements d'enseignement supérieur et des universités, le gouvernement a ainsi lancé par décret la **mise en place de l'Instance nationale de l'évaluation, de l'assurance-qualité et de l'accréditation de l'enseignement supérieur**.

Deuxième axe : le développement régional et la performance des services sociaux

L'objectif des réformes proposées à ce titre est de réduire le déséquilibre régional et d'assurer la promotion des services sociaux notamment les services de santé et les programmes de sécurité sociale.

Développement régional et collectivités locales

Un premier levier d'action réside dans le renforcement des mécanismes de financement des collectivités locales et la réduction de leur endettement, tout en assurant l'harmonisation entre la fiscalité locale et les orientations des politiques sectorielles. Le gouvernement a ainsi, dès la loi de finances complémentaires 2012, décidé du **déplafonnement de la taxe TCL appliquée aux entreprises** au niveau des collectivités locales. Dans un second temps, dès 2013, le **code de la fiscalité locale sera modifié pour renforcer les moyens des communes et l'équité fiscale**.

Programmes de protection sociale et performance des services sociaux

Un deuxième levier concerne l'efficacité et la performance des programmes de protection sociale et la performance des services sociaux. Les résultats attendus des réformes dans le domaine social consistent à renforcer la responsabilité et la qualité des services et des investissements publics en particulier dans les régions défavorisées.

Les actions de réformes prévues ont trait à :

- L'institutionnalisation de **l'audit participatif du Contrôle Général des Services Publics** à travers l'adoption d'un **décret instituant l'audit transparent et participatif des performances des services publics dans la mission du Contrôle Général des Services Publics**. Cette mesure

améliorera la transparence et ainsi la redevabilité des services publics en particulier dans les régions les moins favorisées.

- L'établissement d'un **système d'information consolidé des programmes de la sécurité et de la protection sociale sur la base d'un identifiant unique et l'adoption d'un système de vérification et de ciblage raffiné des bénéficiaires**. Cette mesure sera essentielle pour déterminer les bénéficiaires effectifs de l'ensemble des programmes sociaux et d'en améliorer le ciblage et l'efficacité.
- A l'instar de l'enseignement supérieur, le renforcement des modalités de suivi de la qualité des services de santé à travers l'adoption d'un décret pour la création d'un organisme indépendant pour l'accréditation/certification des structures et services de santé.

Troisième axe : la bonne gouvernance

Dès 2011, les autorités ont lancé un vaste programme de réformes dans ce sens (liberté d'association, accès à l'information, publications de données statistiques, ….). Ces politiques publiques doivent maintenant être largement diffusées. Et les actions de simplifications doivent se poursuivre.

Les réformes prévues dans ce domaine visent à renforcer les principes de transparence et de reddition de comptes par le renforcement des mécanismes de contrôle administratif et financier, l'amélioration de la réglementation des marchés publics, la facilitation de l'accès à l'information dans le cadre du « gouvernement ouvert » et la réforme des systèmes judicaire et médiatique. Elles touchent toutes les dimensions de la gouvernance et de la lutte contre la corruption.

Finances Publiques

L'adoption d'une politique proactive et transparente des finances publiques basée sur la dissémination de l'information sera de nature à assurer la confiance du public dans le Gouvernement, à favoriser un débat fructueux autour des décisions publiques et à renforcer la participation du public directement ou indirectement à travers le Parlement aux orientations, aux choix et aux priorités nationales.

Une des mesures du gouvernement en 2012 a été **d'informer l'ensemble des administrations, à travers une circulaire du gouvernement et dans le cadre du partenariat multilatéral « Open Government », des modalités de mise en œuvre du décret-loi relatif à l'accès aux documents administratifs des organismes publics adopté en avril 2011**. Dans le cadre de ce même partenariat, les services du Ministère des Finances ont reçu l'instruction de procéder **à la publication de documents essentiels tels que le cadrage budgétaire, le projet de budget du gouvernement et les rapports d'exécution budgétaire.**

Dans le domaine de la **passation des marchés,** essentiel à la fois pour la relance de l'investissement public et la lutte contre la corruption, le gouvernement actuel poursuivra les travaux engagés pour revoir le cadre réglementaire, selon les standards internationaux et les **recommandations du rapport d'évaluation OCDE/DAC, et déterminera le plan d'actions qui en découle, en décembre 2012**.

Enfin, le gouvernement poursuivra l'effort de **revue de l'ensemble des dispositifs de contrôle afin de limiter les contrôles a priori,** sur la base de propositions du comité sur la modernisation des contrôles administratifs et financiers. Le gouvernement définira un processus de rationalisation de la

fonction de contrôle dans le cadre d'une feuille de route approuvée en Conseil Interministériel. En parallèle, le gouvernement lance un diagnostic sur la gouvernance des entreprises publiques dans ce même objectif de rationalisation et de renforcement des performances de l'administration.

Secteur de la justice et lutte contre la corruption

Le programme de réformes dans le domaine de la gouvernance se poursuivra dans le sens du renforcement de toutes les dimensions de transparence et de redevabilité notamment à travers le développement de l'appareil judicaire et le cadre opérationnel relatif à la lutte contre la corruption.

En novembre 2011, le gouvernement a créé une Autorité de Lutte contre la Corruption, dont le président a été nommé en mai 2012. Les membres de cette autorité sont en cours de nomination. Le renforcement du dispositif se matérialise maintenant par l'adoption par le Gouvernement et la soumission à l'ANC d'un projet de loi sur l'Instance judiciaire transitoire remplaçant le CSM.

Plus spécifiquement, pour lutter contre la corruption dans les affaires financières et renforcer les capacités de la justice, le Ministère de la Justice a créé un pôle judiciaire spécialisé dans les dossiers économico-financiers. Cette unité permettra de mener des investigations sur des cas de corruption complexes avec la création d'un groupe de magistrats spécialisés et participera à un renforcement de la transparence et de la compétitivité de l'économie.

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L'ampleur des actions de réformes de ce programme d'appui à la politique de développement du pays démontre clairement la ferme volonté de l'Etat de s'engager dans un nouveau processus de changement concret et efficace de toute l'œuvre de développement, unique garant d'une transition démocratique réelle qui doit permettre de hisser le taux de croissance à des niveaux qui soient à la hauteur des défis de création d'emploi et de transformation radicale du paysage régional du pays.

L'assistance technique et l'appui financier à cet effort de réformes s'avèrent une condition de premier plan pour surmonter les contraintes présentes et futures que confronte la Tunisie.

A l'instar du premier programme, l'Etat tunisien est résolu à mettre en œuvre toutes les réformes prévues dans ce deuxième programme d'appui à la relance afin d'assurer la réussite de la phase transitoire et la bonne marche vers la démocratie et le développement inclusif et sollicite les partenaires de la Tunisie en l'occurrence la Banque Mondiale, la Banque Africaine de Développement et l'Union Européenne pour un appui financier substantiel et rapide.

Ministre de l'Investissement et de la Coopération Internationale

Signé: Riadh BETTAIEB

Republic of Tunisia October 9, 2012

Mr. Jim Yong Kim
President, World Bank Group
Washington, DC

Letter of Development Policy

Dear Mr. President:

Tunisia is embarking on a new phase in the historical transition process, the highlight of which was the January 14, 2011 people's revolution, after successfully holding the elections of the Constituent National Assembly and forming a new government. These steps should reinstate the legitimacy of the institutions once the new constitution is adopted and new national and local elections are organized.

The principal challenge for Tunisia is to ensure economic and social stability given the unfavorable outlook at the regional and international level, with the ongoing crisis in the European Union and the unstable situation in Libya.

Tunisia is in effect experiencing a new period of transformation, which generates new challenges and opportunities for the country's economy. The requirement is to reestablish a good pace of economic growth after the unprecedented contraction of roughly 2 percent in 2011, and the requirement of easing social tensions, fostering job creation, and reducing regional disparities by addressing the pressing needs of the country's disadvantaged regions.

In this context, the development work Tunisia began in 2011 stands out in terms of its urgency and its strategic dimension; the Government must indeed rise to a short-term challenge of jump-starting the economy while preserving the country's medium-term macroeconomic stability, and launch a structural reform process that will establish the bases of a new model of development. This is the basic requirement for the success of the country's transition to democracy.

1. Macroeconomic framework and strategy

For the economy, the priority of the political transition from the outset has been jump-starting economic activities and once again instilling a climate of confidence to energize domestic and foreign investments. After a 2 percent drop in GDP in 2011, the beginning of 2012 saw promising signs of economic recovery. Nonetheless, the effects of the eurozone crisis and the increase in commodity prices began to affect

Tunisia's economy beginning in the second quarter of 2012. Although average GDP growth was 3.3 percent in the first six months of the year, growth was not as vigorous in the second quarter of the year, at 2.1 percent versus 4.6 percent in the first quarter. While the agriculture and tourism sectors performed well, in the export manufacturing sectors, and textiles and the mechanical and electric industries in particular, activity was off in the second quarter of 2012 by 8.6 percent and 8.2 percent, respectively. From the target of 3.5 percent growth for 2012, the Government expects to raise the growth level to a higher level consistent with lower unemployment, to 4.5 percent in 2013, then to 5.2 percent, and to 6.3 percent in 2014 and 2015, respectively.

At the same time, the higher price of commodities has been generating inflationary pressure since the end of 2011. Inflation reached 5.5 percent year-over-year in September 2012, versus 3.3 percent one year earlier. Since the revolution, the Central Bank has continued to support the economy through massive injections of liquidity and by lowering interest rates and the reserve requirement. To deal with inflation, the monetary authorities raised the interest rate from 3.5 percent to 3.75 percent in late August 2012. Inflation is expected to remain at 5.5 percent in 2012 and then slow gradually from 4.8 percent in 2013 to 4.3 percent in 2015.

The exports that were severely affected in 2011, namely tourism, transportation, phosphate, and energy, have benefited from the recovery, with a 40 percent increase in revenue from tourism in the first eight months of 2012. While recovery has begun in most sectors, the export manufacturing sector has been gradually affected by the economic recession in the eurozone, especially since the second quarter of 2012. Moreover, the rise in imports was reinforced by high prices of petroleum products and food, combined with the depreciation of the dinar. The trade deficit grew by more than 50 percent in the first eight months. The current account deficit, which had already reached 7.3 percent in 2011 (a historically very high level for Tunisia), was 5.6 percent of GDP as of late August 2012 (as opposed to 3.9 percent one year earlier). This resulted in a lower level of external reserves at 9.8 million dinars (96 days of imports) as of end-September 2012, versus 10.5 million dinars (113 days of imports) one year earlier. The Government intends to gradually lower the level of the current account deficit to a more sustainable level, from 7.4 percent in 2012 to 5.4 percent in 2015, primarily by energizing the export sector. Based on the recovery of the European economy, real growth in exports of goods and services should be at a sustained pace of 6.1 percent in 2013 and then reach 8.1 percent in 2015.

For the budget, the 2012 Supplementary Budget Law, enacted in May 2012, provides for major measures for recovery and social stabilization with a 22 percent increase in spending. This increased spending, included in the 2012 budget, is explained by a 17 percent increase in current expenditures and 30 percent in public investment. The good performance of tax and non-tax revenues, with the contribution of non-recurring financing, such as the use of revenue from privatizations and the sale of ill-gotten gains, will be consistent with the budget deficit level of 6.6 percent of GDP (versus 3.5 percent in 2011), in accordance with the 2012 Supplementary Budget Law. The Government has taken steps to harness the level of subsidies, which has become unsustainable. In fact, to meet social demand and to deal with higher prices for food and hydrocarbons, the amount allocated to subsidies in 2012 exceeded by far the initially planned amount and rose to 6 percent of GDP. Beginning in September 2012, the Government

adjusted the price of fuel upward. In 2013, the Government intends to initiate the reform of the clearing system to better target beneficiaries and control spending on subsidies. Likewise, the reform of the retirement fund is expected to be introduced in 2013 to improve its sustainability given the demographic trends in Tunisia. In the medium term, the Government intends to begin major reforms for the efficient and sustainable management of public finance, including in the areas of recapitalizing the public banks and the arrears with the public enterprises. Efforts will also be made to better harness the wage bill. These reforms will help bring the deficit down gradually to a more sustainable level of 5.9 percent of GDP in 2013 and 4.1 percent in 2015, with priority on social inclusion and re-energizing the economy. Likewise, the level of public debt should be brought under control in the medium term, although a temporary increase from 46 percent to 48 percent from 2012 to 2014 will be tolerated.

According to projections, external financing requirements will remain at a high level in the coming years with a gradual decrease from 7.967 billion dinars in 2012 to 7.695 billion dinars in 2015. Reserve levels should remain steady at roughly 110 days of imports during the period. To confront the challenges of the transition to democracy, the economic consequences of which were exacerbated by the external shocks, the contribution from the development partners will be crucial to support government reforms as well as to mobilize the financing resources that are necessary during this historic phase for Tunisia.

2. The Government's development strategy

Realizing the necessity of strengthening the content of the structural reforms and accelerating the pace to bolster the resumption of economic activity, the Government prepared a development strategy in conjunction with the emergency action plan. This strategy includes a new vision for the future of Tunisia and recommends a new plan for society that seeks to be comprehensive, inclusive, and balanced.

This strategy provides for a series of structural reforms over the medium and long term to create conditions for accelerated growth and job creation in an effort to achieve regional balance and inclusive development. It is based on five pillars: economic and social reforms; infrastructure modernization; regional rebalancing; strengthening the social, education, and employment sectors; and promoting sustainable development taking natural resources into account.

Economic and social reforms

This entails putting in place the conditions for a more transparent and efficient government, improving public financial management, bolstering the business climate, and thus promoting international investments and partnerships.

Improving the business environment should include strengthening competition in the domestic market, easing regulatory barriers and improving the interventions of public support and control bodies, and developing partnerships between the public and private sectors. The reforms may also involve revising the investment incentive code for greater transparency, facilitation and freedom for entrepreneurship, and revising the tax and customs systems.

The economic reforms will be part of a process of strengthening **external liberalization.** The opening of Tunisia to the outside is a strategic choice for Tunisia in order to hasten the pace of growth, create new jobs, transfer technology, and obtain the financing appropriate for development. Improving cooperation with the European Union for a special partnership will strengthen the liberalization process.

There will be efforts to streamline **the financial sector** as well. The process of liberalizing capital movements will be continued gradually to ensure that external financial resources are available for the national economy and to help attract direct foreign investment in all the sectors of the economy. The main activities will be to strengthen the effectiveness of bank intermediation by improving bank portfolios, building their financial and technical capacities, upgrading their methods of management and governance, and diversifying bank services like Islamic finance. The microfinance, capital investment, and financial market sectors will also undergo reform.

Upgrades to infrastructures

Integrating Tunisia's economy with the global economy, and in particular the European Union and the Maghreb region, as well as improving the business climate and better balancing regional development, makes it necessary to improve and upgrade infrastructures, and logistical infrastructures in particular, such as deep-water ports, the rail transportation network, the power grid, etc.

The telecommunications infrastructure will be upgraded by expanding the coverage rate and connection capacities, by amending the regulatory framework and reorganizing the Internet sector, and by optimizing the management of technological and virtual spaces.

Regional rebalancing

A better distribution of wealth and growth potential among the different regions of Tunisia is essential, as imbalances are often sources of revolution. This rebalancing requires efforts not only in governance, with a process of decentralization/deconcentration, but also in physical infrastructures, including roads, water, sanitation and energy, and investment in human capital, including education, higher education and health, and improvements in telecommunications.

Reducing disparities between regions will be facilitated by an equitable distribution of public investments according to objective criteria, as well as the preparation of regional development programs suited to the specific features and resources of each region, and improved effectiveness of integrated development programs.

The reform projects also include encouraging the establishment of productive investments in the interior regions and improving their comparative advantages. Special effort will be made to upgrade infrastructure in rural areas and have community facilities in every region of the country in order to improve living conditions and meet the needs of the new regional dynamic.

Strengthening the social, education and job sectors

The Government will concentrate on the social and education sectors, from strengthening the quality and governance of these systems to upgrading them in accordance with good practices and international standards. For education, the goal is to have an education system with primary education, vocational

training, and higher education that is tailored to the country's demographic evolution and supports the development of sectors with higher added value and business competitiveness.

The improvement in the quality and efficiency of these sectors will require in particular greater autonomy for businesses and heightened emphasis on the quality of the services that are provided.

Likewise, the Government will continue to overhaul the active employment policy and encourage independent work as well as social security system reform.

Promote sustainable development using the country's natural resources

This entails preserving the ecosystems (primarily the marine ecosystem) and controlling desertification, strengthening pollution control, including water pollution through sanitation programs, as well as solid contamination and air pollution, strengthening efforts in energy efficiency, and developing renewable energy.

3. Specific reforms begun in 2012

To implement the activities and programs that are part of this strategy, the Government is working to implement the activities in the first recovery support program in 2011, and is focusing on preparing an ambitious reform program for 2012. The list of Government reforms and commitments is now online in matrix form at the following Government of Tunisia web site:

(http://www.tunisie.gov.tn/index.php?option=com_content&task=view&id=1883&Itemid=518&lang=french).

This reform program, carried out alongside the short-term fiscal recovery effort, focuses on three major public policy objectives: growth and job creation, regional development and social protection, and good governance.

Area 1: Growth and job creation

Business climate and competitiveness

The reform program works in conjunction with the fiscal recovery, which is in part based on public investments. The first activity is thus to accelerate the implementation of investment programs. Procurement processes have always been particularly cumbersome in terms of procedures and implementation. Therefore, the Government launched a **process to streamline and clarify procurement processes and took steps to accelerate the execution of the investment budget,** resulting in the issuance of an order on the regulation of government contracts, and of a circular letter from the Head of the Government on shortening time frames and facilitating procedures for providing commitment loans for public investment projects in 2012. Likewise, the Government prepared a summary of public investment commitments by sector of activity and governorate in order to establish greater transparency and to make all the stakeholders accountable.

The Government is also intent **on improving the business environment**, which, until the revolution, lacked transparency and anti-competitive situations were the rule. Thus, the idea is to ease constraints

and administrative authorizations, limit possibilities for decisions of a discretionary nature, bolster the transparency of investment-related procedures, and reduce monopolies and oligopolies.

The Head of the Government thus issued an order that launched a **reform to streamline administrative procedures in the business environment** in every area related to investment and activity in the private sector and to curb the discretionary authority of administrative managers for implementation.

This decision is the first step in a detailed review of regulation, which will include the **revision of the investment incentives code to align it with internationals standards**. This revision, which will be a complete revision of the law, will in particular aim to streamline tax and non-tax incentives and to curb the disparities between the offshore and onshore sectors of the economy.

To foster and increase local and international investments, the Government wishes to promote **the development of public-private partnerships** that will improve the quality and diversity of services while lowering the cost for the Government. To achieve this, a change in the regulation is necessary in order to expand PPP procedures, which today are limited to concessions. **A new law on PPPs and harmonization of the implementing regulations will be necessary**.

The reform program also includes activities to reform competition conditions among economic stakeholders. In fact, **many** business sectors are over-regulated, which is a major obstacle to investment. For this reason, the Government has committed to reform the competition law in order to lessen its discretionary application and to enhance the transparency of the Competition Council's action. To strengthen competition, it will also be necessary **to expand automatic authorizations for foreign franchises**, especially in the food sectors.

It is possible to accelerate the resumption of growth by bolstering competition in certain sectors, which, in the current context, have a negative impact on the competitiveness of the Tunisian economy. This applies in particular to the **telecommunications** and **aviation** sectors.

In the **telecommunications** sector, except for mobile telephones, the weak competition among the stakeholders in the data exchange and international telecommunications segments generates very high prices. Likewise, the infrastructures in the country's interior are not being used optimally. **Steps must be taken promptly to open access to cable landing stations for Tunisie Telecom's international telecommunications**. The role of the Tunisian Internet Agency (ATI) will be reviewed as well. **The alternative infrastructure operators such as STEG, SNCFT, etc., may lease their surplus capacity** and offer cross-border connectivity. New international licenses will be granted. Finally, the National Telecommunications Agency (INT) will act to impose a gradual and significant decrease in the costs of international pricing for Internet exchanges and international calls. Finally, the Government will clarify the roles and responsibilities of the different stakeholders, and of the National Telecommunications Agency and the Tunisian Internet Agency in particular.

In the **aviation** sector, the restrictive licensing system limits the country's tourism potential by making air transportation costly. The liberalization of the transportation sector is thus a major competitiveness issue and is part of the Tourism 2016 strategy that the Government adopted. The Government thus

hopes to move toward opening its airspace and will begin **negotiations to align the regulations with the *acquis communautaire* and the Open Skies agreement with the European Union**.

Through this set of actions, the Government intends to create conditions favorable for private investment and growth. However, in a context of economic recession and a depressed international environment, sectors must receive support in a process to end the crisis.

The Tunisian economy is primarily **an economy of SMEs**. Many SMEs have been seriously affected by the crisis and a restructuring effort is essential. Thus, improving the business environment requires **a reform of the regulation on struggling businesses**; this will facilitate restructuring those businesses, ease the burden of non-performing loans, and deregulate financing margins for strong businesses.

The **tourism** sector, which accounts for a large part of non-performing bank loans, must be given special treatment with a strong commitment from the Government, banks, and professionals in the sector. Indeed, the structural crisis that this sector has been experiencing for a number of years has been exacerbated by the aftermath of the revolution. The most unprofitable hotel units that are still in business tarnish the sector's image, weaken its competitiveness, and harm the banking sector. To address the matter of the sector, the Government is preparing **to create an asset management company by end-2012**, which will be in charge of restructuring the units that are not viable.

Financial sector

To return to sustained growth, it is also necessary to have a **stabilized, improved and diversified financial sector**. Thus, the Government will continue its efforts along these lines, using as a basis the reforms begun in 2011 in the banking sector, the diversification of financing tools such as markets and deposit funds, and the development of microfinance and investment capital. The programs planned in the financial area will strengthen the financial position of the public banks, refine risk analysis, ensure financial stability, develop the regulatory framework, and improve the capital market operations in accordance with best practices and international standards.

The first challenge is **banking sector stability**, where problems transcend the tourism sector alone. Owing to weak governance, and subject to considerable political pressure, this sector, and public banks in particular, has accumulated large stocks of non-performing loans with excessively low rates of provisioning. Major action must be taken so that the sector can play its role of financing development and growth. This applies to the public banks in particular. The first steps were taken in 2011 when the Central Bank conducted stress tests and changed the rules of governance. The Government will continue its efforts in cooperation with the Central Bank.

By **launching three strategic audits of the STB, BH and BNA**, for which the request for information was published, the Government plans to launch a major process of restructuring the public banking sector, including recapitalizing them. At this point, **an initial recapitalization of the STB has been authorized so that the STB is able to meet its 8 percent solvency ratio in December 2012**.

Financial stability must be strengthened and the prudential rules must gradually move toward international standards. This is how the Central Bank has **strengthened the key aspects of prudential regulation**.

Along with strengthening the sector's stability, the financing tools for the economy must be diversified from financing for the VSEs to capital market access:

- The promotion of the **microfinance** sector will continue by effectively implementing the essential regulatory framework, i.e. issuing implementing regulations for the microfinance law to establish procedures for approval, and establishing a regulatory authority.
- **Capital investment**, particularly useful to support business growth and development, will also enrich its regulatory framework by issuing and publishing the implementing regulations for the 2011 investment capital law.
- Finally, the Government wishes to place more importance on the **capital market** by fostering the emergence of a secondary market. Action will be taken along these lines to facilitate the emergence of a true rate curve so that new stakeholders will be able to intervene.

Labor market, short-term job program and higher education

Employment is the main challenge for Tunisia. The problem can be solved completely only in the medium term, and doing so requires a series of **structural reforms** as well as support for the private sector, as only the private sector can create jobs with the high added value necessary to provide jobs for graduates of higher education institutions, and for women in particular. In addition to support for the private sector, **it is necessary to further curb barriers to the labor market**.

Therefore, the Government began a national dialogue with the labor and management partners (UTICA and UGTT) with the goal of **signing a new social contract in January 2013** for the country; this will be a first step toward a reform of the labor code, which addresses decent professional labor relations, job and vocational training policies, social coverage and income policies, collective bargaining, and regional development policies.

The labor market reforms aim to bolster the effectiveness of the active employment policies in terms of improving the stability and quality of jobs created for youths, job attractiveness, oversight of employment program performance, and building the capacity of employment agencies based on the amount of time spent searching for a job and filling job offers. These focus primarily on:

- Revising Order 349-2009 that establishes the National Employment Fund programs (Fonds 21/21), to **strengthen and improve the effectiveness and governance of the Active Employment Policies (PAE)**, by strengthening school-to-work transition programs and implementing an institutional and legal framework to monitor and evaluate PAEs. At the same time, the Government is preparing to **reorganize the National Employment and Independent Labor Agency (ANETI)**.
- Establishing flextime in the civil service to make it easier for women to be in the job market. The **regulation of the civil service in terms of hours worked has thus been modified and now includes flextime and the implementation of** the five-day week. At the same time, the Government is studying reform possibilities to preserve and strengthen the role of women in Tunisia's economic and social activities, for example, harmonizing public and private regulations on **maternity leave**.

The Government also wishes to stress the necessity of strengthening the quality of the higher education system. The Government took the first step toward greater autonomy of higher education institutions and universities by issuing an order to **establish the National Agency for the Evaluation, Quality Assurance and Accreditation of Higher Education**.

Area 2: Regional development and the performance of social services

The purpose of these proposed reforms is to lessen regional imbalance and promote social services, especially health services and social security programs.

Regional development and local governments

The first area of action will be to strengthen financing mechanisms for local governments and reduce their debt, while harmonizing local taxation and sector policy guidelines. Thus, beginning with the 2012 Supplementary Budget Law, the Government decided to **lift the ceiling for the local government tax (TCL) that businesses pay** to local governments. Subsequently, beginning in 2013, the **local tax code will be amended to strengthen the resources of communes and equity in taxes**.

Social protection programs and the performance of social services

The second area of action is the effectiveness and performance of social protection programs and the performance of social services. The expected results of the reforms in the social area are greater accountability and better quality of services and public investments, in particular in the disadvantaged regions.

The planned reform programs will:

- Institutionalize the **participatory audit of the General Accounting Office** by issuing an **order that institutes the transparent and participatory audit of the performance of public services in the mission of the General Accounting Office**. This measure will improve transparency and hence the accountability of public services, especially in the disadvantaged regions;
- Establish a **consolidated information system of security and social protection programs based on a unique identifier and adopt an upgraded system to check and target beneficiaries**. This measure will be essential for establishing the actual beneficiaries of all social programs and to improve targeting and effectiveness;
- Following the example of higher education, strengthen procedures for monitoring the quality of health services by issuing an order to create an independent body to accredit/certify health facilities and services.

Area 3: Good governance

In 2011, the authorities launched a major reform program for good governance, including freedom of association, access to information, statistical data publications, etc. These public policies must now be broadly disseminated, and activities to streamline them must continue.

The planned reforms in this area aim to strengthen the principles of transparency and accountability by strengthening administrative and financial control systems, improving the regulation of government contracting, facilitating access to information under Open Government, and reforming the judicial and media systems; they apply to every dimension of governance and anti-corruption efforts.

Public finance

The adoption of a proactive and transparent public finance policy based on the dissemination of information will instill the public's confidence in the Government, foster a worthwhile debate on public decisions, and strengthen public involvement directly or indirectly through the Parliament for policies, choices, and national priorities.

One of the measures the Government took in 2012 was to **inform all the agencies through a Government circular letter and as part of the Open Government multilateral partnership of the procedures for implementing the decree-law, enacted in April 2011, on access to the administrative documents of government agencies**. Under this same partnership, Ministry of Finance staff was instructed **to publish essential documents such as the budget framework, the Government's draft budget, and the budget execution reports**.

In the area of **procurement**, essential for jump-starting public investment and combating corruption, the current Government will continue the work begun to review the regulatory framework according to international standards and the **recommendations of the OECD's Development Co-operation Directorate, and will decide on the ensuing action plan in December 2012**.

Finally, the Government will continue the effort of **reviewing all control systems to limit ex ante control** based on the committee's proposals to upgrade administrative and financial control. The Government will identify a process to streamline the control function as part of a roadmap approved by the Interministerial Council. At the same time, the Government will launch an assessment of the governance of public enterprises with this same goal of streamlining and strengthening the performance of government bodies.

Justice sector and corruption control

The reform program in the area of governance will continue to bolster every dimension of transparency and accountability, mainly by developing the judicial apparatus and the operational framework for combating corruption.

In November 2011, the Government established the Corruption Control Authority, and the president was appointed in May 2012. The members of this authority are now being appointed. Having the Government enact and submit to the Constituent National Assembly a draft law on the Transitional Judicial Authority that will replace the Supreme Council of Magistrates (CSM) is strengthening the system.

More specifically, to combat corruption in financial matters and to strengthen the capacities of justice, the Ministry of Justice established a judicial center that specializes in economic/financial matters. This unit will conduct investigations into complex cases of corruption, establish a group of specialized magistrates, and will take part in strengthening transparency and economic competitiveness.

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The scope of this program's reform activities to support the country's development policy clearly demonstrates the Government's firm resolve to engage in a new process of concrete and effective change in the entire development effort, as this is the only way to ensure a real democratic transition that will improve growth rates to levels that are commensurate with the challenges of creating jobs and radically transforming the country's regional landscape.

Technical assistance and financial support for this reform effort are an essential requirement to overcome Tunisia's current and future constraints.

Like the first program, the Government of Tunisia has resolved to implement all the reforms of this second recovery support program to ensure the success of the transitional phase and to advance toward democracy and inclusive development. Tunisia calls on its partners, that is, the World Bank, the African Development Bank, and the European Union, for substantial and expedited financial support.

/s/

Riadh Bettaieb

Minister of Investment and International Cooperation

ANNEX 2: POLICY AND INSTITUTIONAL REFORMS MATRIX AND RESULTS FRAMEWORK

Development objective	Policy and Institutional Reforms		Expected Results		
			Indicator	Baseline 2012	Target 2014
	GOJ DPL 2012	GOJ2 DPL 2013			
FIRST PILLAR: ATTRACTING INVESTMENT AND JOBS CREATION					
A more competitive business environment by reducing red-tape, simplifying the investment code, improving the legal framework for bankruptcy and for competition, and opening up the telecommunications sector	**Decree No.2012-1682 (*"Décret relatif à la mise en place d'un processus participatif pour l'évaluation et la révision des procédures administrative régissant l'exercice des activités économiques"*) dated August 14, 2012, institutionalizing a systematic and participatory reform process of business formalities, based on streamlining of procedures, transparency, and reduction of arbitrary and discretionary behavior; and committing to deliver concrete reforms within 9 months of its publication, in the areas related to private investment, has been published in the National Gazette No.72 dated September 11, 2012.**	The Council of Ministers has adopted the report from the systematic and participatory reform process of business formalities, and containing the recommendations on streamlining of procedures and reduction of arbitrary and discretionary behavior in the areas related to private investment	Quantitative estimate of compliance costs: direct costs, number of days for the 15-20% top priority business formalities.	Baseline will be determined once an inventory of business formalities is completed (in December 2012).	Reduction by 20% of compliance costs with selected business formalities
		The new Bankruptcy Law (which merges the Chapter IV of the Commerce Law and the Law N° 95-34) has been published in the National Gazette.	Number of judges and lawyers trained in the new bankruptcy procedures	None	At least 15% of the judges have been trained to the new Insolvency regime (i.e 300 judges out of the 2,000), and at least 100 lawyers trained in the insolvency regime by 2014 of which at least 30 will be women.
		The new Investment Incentives Code (which consists of a complete revision of the Law N° 93-120 of 27 December 1993 and its subsequent revisions) has been published in the National Gazette.	Estimated fiscal cost of the investment incentives	Baseline will be determined in December 2012.	Reduction by 20% of fiscal costs of investment incentives

		The new Competition Law, (which revises Law 91-64 of 29 July 1991) has been published in the National Gazette.	Product Market Regulation (PMR) Barriers to Competition Index	Baseline will be determined once the PMR indicator is calculated pending finalization of data collection	Reduction by 15% (based on barriers to competition and antitrust exemption indicators)
	The President of the National Telecommunication Authority has issued Decision No.67/2012 ("Décision No. 67/2012 de l'Instance Nationale des Télécommunications en date du 4 Octobre 2012 portant sur le complément de l'Offre Technique et Tarifaire d'Interconnexion de la Société Nationale des Télécommunications pour l'année 2012, relative à l'accès à la station terrienne d'atterrissement des câbles sous-marins ») dated October 04, 2012, to open up access to the landing stations of international telecommunications cables to more operators in addition to Tunisie Telecom.	**Approval by INT of a technical and price offer by the three holders of alternative fiber optic backbone infrastructure (SNCFT, TA and STEG) to lease capacity to licensed operators, to the ISPs and to "private" networks (e.g. networks of schools, networks of private banks etc), on a non-discriminatory and cost-oriented basis.**	Price of international telecommunications (Skype Termination Rate to Tunisia in cents/min) Available international bandwidth	2012 value : 39.5 US cents/minute 2011 = 37.7 Gbps	End 2013: 20 End 2014: 10 2013 = 120 Gbps 2014 = 220 Gbps
SECOND PILLAR: STRENGTHENING THE FINANCIAL SECTOR					
A strengthened financial sector by improving the financial position and governance of public banks		**The Law establishing an Asset Management Company to deal with the debts in the tourism sector has been published in the National Gazette.**	Percentage of problem loans in the tourism sector that have been transferred to the AMC	None	At least 15% of the tourism sector loans classified 4 and 5 by the CBT are transferred to the AMC by end-2014.
	The Governor of the Central Bank has issued Circular No. 2012-09 (*"Circulaire aux établissements de crédit No. 2012-09 relative à la division, couverture des risques et suivi des engagements*"), dated June 29, 2012, revising the Circular 91-24 dated December 17, 1991 outlining stricter prudential regulations for the banking sector.	**Strengthen the governance of public banks by increasing the independence of their Boards and management teams.**	Minimum solvency ratio for banking system (CAR)	Minimum 8%	Minimum 9%

	The Minister of Finance has issued the call for Expression of Interest to contract one or more firms to carry out strategic and financial audits of the three public banks, namely *Société Tunisienne de Banque* (STB), *Banque de l'Habitat* (BH), and *Banque Nationale Agricole* (BNA).	Prepare restructuring plans for the 3 banks based on the results of the audits.	Restructuring strategies for STB, BH and BNA	None	Restructuring strategies for STB, BH and BNA have been approved by the Minister of Finance.
THIRD PILLAR: IMPROVING THE QUALITY OF SOCIAL SECTOR SERVICES AND INCLUSIVE POLICIES					
More inclusive and accountable social services by improving quality and governance of ALMPs, health services and education services.	**Decree No. 2369 ("*Décret No. 2012-2369 fixant les programmes du Fonds National de l'Emploi, les conditions et les modalités de leur bénéfice*") dated October 16, 2012, which revises Decree No. 349-2009 dated February 09, 2009, setting the programs of the National Employment Fund, has been published in the National Gazette No 82 dated October 16, 2012**	Reorganization of the National Agency for Employment and Independent Labor (ANETI)	(i) Number of beneficiaries of the Labor Market Programs, (of which female %) (ii) Insertion rate of the Labor Market Programs (as measured by share of individuals who get a contract after program completion):	(i) 45000 (in 2011) (of which 59% female) (ii) 14% (in 2011)	(i) Maintain number of beneficiaries under new programs (of which 60% female) (ii) 20%
	Decree No. 1709 ("*Décret No. 2012-1709 portant création de l'instance nationale de l'accréditation en santé et fixant ses attributions, son organisation administrative, scientifique et financière ainsi que les modalities de son fonctionnement*") dated September 6, 2012, establishing a National Authority for the Evaluation and Accreditation of Health Services and setting its administrative, financial and operational modalities, has been published in the National Gazette No.72 dated September 11, 2012.		Number of hospitals that have conducted and published results of evaluations of hospital services and have instituted improvement plans (among regional and university hospitals, n=55)	0	At least 5 (increase by at least 10%)

	Decree No. 1719 (*"Décret No. 2012-1719 fixant la composition de l'instance nationale de l'évaluation, de l'assurance qualité et de l' accreditation et les modalities de son fonctionnement"*), dated September 14, 2012, establishing the National Authority for the Evaluation, Quality Assurance and Accreditation of higher education, has been published in the National Gazette No.73 dated September 14, 2012.	Modify the Administrative Status of Universities to increase their financial and academic autonomy and make them more responsive to labor market needs and local social and economic needs.	Programs and institutions evaluated and accredited	33 programs have been evaluated 0 institutions have been accredited 0 programs have been accredited	At least 40 programs have been evaluated At least 3 institutions have started the accreditation process
FOURTH PILLAR: STRENGTHENING GOVERNANCE, TRANSPARENCY AND ACCOUNTABILITY					
Increase transparency and accountability in policy making by promoting access to information, introducing greater transparency in public finances, and strengthening the public procurement system.	**The Head of Government has issued Circular No. 25-2012 (*"Circulaire No. 25 [concernant] l'accès aux documents administratifs des organismes publics"*), dated May 5, 2012, specifying the procedures for the implementation of the Decree-Law 41-2011 dated May 26, 2011 which aims at promoting transparency and harmonizing the means and procedures regarding public access to documents held by public agencies.**	Strengthen the implementation of the Access to Information through the establishment of an independent commission of experts ('Information Commission'). This commission will be in charge of monitoring the implementation of the right to access to information and to provide opinions/advice and to deal with citizens complaints.	Number of information request granted	None	25 request for information have been granted
	The Minister of Finance has issued Decision No. 278 (*"Note [concernant] la publication des données et informations relatives aux Finances Publiques"*), dated August 25, 2012, mandating the publication of key information on public finances, including a Citizen's Budget providing an online open budget platform which allows citizen's direct access to detailed and real time public expenditure data.		Information on public finances is published on the Ministry's website	The draft budget and the budget execution reports are not regularly published. Public expenditure data is not available online.	The draft budget and the budget execution reports are published on a regular basis. Public expenditure data is available online, including the mapping of regional investment projects.
	Evaluation of the national public procurement system: Approval by government of the evaluation report and related action plan of the national public procurement system carried out using the OCDE/DAC methodology.	**The Decree revising the national public procurement system (implementing the key recommendations of the OECD/DAC review) has been published in the National Gazette.**	Average time needed to award a contract	Average of the duration of contract award process = 200 days	Decrease by 30 % of the average duration of contract award process (from bid submission to date of contract signing).

ANNEX 3: JOINT POLICY REFORMS MATRIX [74]
(GOVERNMENT REFORMS PROGRAM JOINTLY SUPPORTED BY WORLD BANK, AfDB and EU)

TUNISIA BUDGET SUPPORT PROGRAM
PRIORITY REFORMS 2012-2013

Reforms completed as of September 2012	Reforms to be completed before the end of the year 2012
Growth and Employment Creation:	
A.1 Business Climate and Competitiveness	
Adoption by the Prime Minister of a Decree relating to the simplification of the administrative procedures in the areas related to private investment.	Reform of the Investment Incentives Code: Adoption by the Council of Ministers and the submission to the Constituent Assembly of a new Investment Incentives Code (which constitutes a thorough revision of the Law n° 93-120 dated 27 December 1993 and of the successive amendments to that Law).
	Revise the Bankruptcy Law: Adoption by the Council of Ministers and submission to the Constituent Assembly of the new Bankruptcy Law (which merges the Chapter IV of the Commerce Law and the Law N° 95-34)
	Adoption by the Council of Ministers and submission to the Constituent Assembly of draft Law establishing an Asset Management Company to deal with the debts in the tourism sector.
	Launch the negotiations with the European Union on the "Open Skies" Agreement and launch a process of revision of the relevant legal framework to adopt the EU regulations.
	Adoption by the Council of Ministers and submission to the Constituent Assembly of the revised Competition Law (which revises Law n° 91-64 dated 29 July 1991) to reduce its discretionary application and increase the transparency of the actions of the Competition Council.
Reforms in the Information and Communication Technology (ICT) sector: (i) Decision of the President of the National Telecommunications Regulator (INT)	The Reforms in the Information and Communication Technology (ICT) Sector:

[74] This reform program has been posted on the government web portal in September to seek feedback from citizens (in Arabic: http://www.tunisie.gov.tn/index.php?lang=arabic and in French: http://www.tunisie.gov.tn/index.php?lang=french).

removing the mandatory passage of international communications through the National Internet Agency (ATI); (ii) Decision of the National Telecommunications Body establishing a policy and related regulations to open access to the landing stations of international submarine cables of Tunisie Telecom (for example, according to operators the right to install equipment directly in Tunisie Telecom facilities).	(i) Decision of the President of the National Telecommunications Regulator (INT) to enable the operators of alternative backbone infrastructure (SNCFT, TA and STEG): (a) to lease capacity to licensed operators, to the ISPs and to "private" networks (e.g. networks of schools, networks of private banks etc), on a non-discriminatory and cost-oriented basis; (b) to provide connectivity across borders (for example, the Tunisian Company of Electricity and Gas to provide connectivity with Algeria to Libya). (ii) According additional international licenses before the end of 2012. (iii) Revision of the legal framework to enable the National Telecommunications Regulator (INT) to regulate international interconnection prices. (iv) Decision of the National Telecommunications Body to reduce international call termination rates, in a progressive three-step process: - October 2012: 25% reduction of international rates of IP connectivity: - December 2012: 25% reduction of the termination rates of international calls - June 2013: second reduction 25 % reduction of the rates of international call termination rates.
	Revision de *Arrete* of the Minister of Commerce of 28 July 2010 relating to the automatic approval of certain types of franchise contracts to extend the authorization provided for in the Article n° 6 of the Law n° 91-64 dated 29 July 1991 with a view to uniform the treatment accorded to nationals and foreign firms.
Adoption by the Council of Ministers of a draft Law relating to Public Private Partnerships (PPP) and transmission to the National Constituent Assembly (ANC) and the adoption of a Decree of the Prime Minister modifying the Decree n° 2008-2965 dated 8 September 2008, relating to the creation of Unit for the monitoring of concessions and all types of PPPs.	Adoption of an application Decree of the new Law on Private Public Partnerships and modification of the application Decree of the Law on Concessions of 2008 to enable the harmonization of the operational procedures to all forms of PPPs to improve transparency.
A.2 The Financial Sector	
Launch by the Ministry of Finance of an international tender to carry out strategic and financial audits of the thee public banks, namely STB (the Tunisian Banking Company), BH (the Housing Bank), and the BNA (the National Agricultural Bank); and the adoption of a resolution of the Board of Directors of the STB to increase the capital of STB.	
Amendment of Circular N.91-24 of the Central Bank of Tunisia outlining stricter	

prudential regulations for the banking sector	
Adoption of a Decree fixing the operational procedures of the Microfinance Supervision Authority and two *Arretes* relating to business licensing procedures and procedures for aligning existing microcredit associations (MCA) to the new legislation.	
Amendment of the Law of 49-2003 relating to Repurchase Agreement and of the application Circular of the Central Bank of Tunisia to foster the emergence of Yield Curve and to facilitate the development capital markets.	
Adoption of the application Decree of the Law of 2011 relating to Investment Capital.	
A.3 Labor market, employment programs and higher education	
Revision of Decree 349-2009 fixing the programs of the National Employment Funds (Fund 21-21) with the aim to consolidate and improve the efficiency and governance of Active Labor Market Policies (ALMPs). Notably: (i) The consolidation of job insertion programs (Internship of Initiation to Professional Life; Contract of Integration of Higher Education Graduates; Contract of Professional Adaptation and Integration; Civil Service Volunteer programme); (ii) Develop and institutional and legal framework to monitor and evaluate the ALMPs.	Reorganization of the National Agency for Employment and Independent Labor (ANETI)
Adoption by the Prime Minister of a Decree introducing flexibility in the working hours in the civil service (with a view to provide more flexibility to civil servants having family responsibilities, notably women)	To facilitate the participation of women in the job market: revision of the Article N.64 of the Labor Code to harmonize that Article with Article N.48 of the Civil Service Statute relative to maternity leave.
	11. Elaboration of a social contract for the period 2012-2020 to be signed in January 2013 through a process of social dialogue (entailing the creation of sub-committees for discussing the key issues, namely: work relationships and decent work; employment and vocational training policies; social security, remuneration and wage policy; collective negotiations and regional development policies)..
11.Adoption by the Prime Minister of a Decree establishing the National Authority for the Evaluation, Quality Assurance and Accreditation of higher education.	
B. Regional Development and Social Protection	

B .1 Regional Development and Local Authorities	
The removal of the Maximum Limit of the Tax on institutions of industrial, commercial or professional nature by amending the provisions of paragraph III of the Article N 38 of the Local Tax Code and the suppression of the related Decree.	
	Amendment of Article N.13 of the Local Tax Code (Law N.11 of 3 February 1997) revising the scope of the application to cases in which there is a requirement to present a certificate delivered by the Tax authorities (referred to in Article n° 13 of the Local Tax Code), with the aim of establishing social equality on the local level and reinforcing municipal resources.
B.2 Social Protection programs and performance of social services	
Adoption of a Circular relative to the establishment of a consolidated information system of social protection programs and the adoption of a sophisticated verification and targeting strategy for the identification of beneficiaries.	Adoption of a Decree which institutionalizes the transparent and participatory audit of the performance of public services in the mission of the General Audit of Public Services (Contrôle Général des Services Publics).
Adoption of a Decree of the Prime Minister for the creation of a National Authority for the Evaluation and Accreditation of Health Services and setting its administrative, financial and operational modalities.	
Measures to accelerate the execution of public investment project: (i) Adoption of the Decree n° 2012-515 dated 2 June 2012, amending Decree 2002-3158 dated 17 December 2002, relating to public procurements regulations, and the Decree n° 2011-623 dated 23 Mai 2011, outlining specific provisions for public procurement regulations. (ii) Adoption of the Circular of the Prime Minister N.2012-41 of 22 June, 2012, reducing the delays and simplifying the procedures to ensure the availability of commitment appropriations to carry out public investment projects in 2012.	
C. Governance	
C.1 Public Finances	
Budget and PFM transparency and eligibility criteria for "Open Government Partnership": Adoption of a Decision by the Minister of Finance on the publication of key public financial management information: (i) the budget circular, a medium term expenditure framework and a pre-Budget statement,	

including the macro-fiscal perspectives and assumptions underlying the budget, at the beginning of the budget process; (ii) the Government and Ministries budget proposal before transmission to Parliament; (iii) the monthly and year-end budget execution reports; (iv) a citizen's budget, i.e., a popularized version of the draft budget (starting from 2014 budget); and (v) the Budget Law settlement of year n-1 accompanying the draft budget of year n+1 (starting from 2014 budget); (vi) an online open budget platform giving citizens direct access to detailed and timely public expenditure data.	
Access to Information and eligibility criteria for "Open Government Partnership": Adoption of a Circular by the Prime Minister specifying the procedures for the implementation of the Decree-Law 41-2011 on the right by the public to gain access to documents held by public agencies.	
Launch a revision of regulatory instruments (on the basis of the proposals of the sub-workgroup on a priori-control of the Committee on the modernization of financial and administrative supervision) to remove a number of a priori controls within a context of a revision of the decrees on administrative and financial supervision; and launch a process to rationalize the control function within the context of a roadmap approved by Council of Minister.	
	Adoption by the Prime Minister of a Decree revising the national public procurement system (implementing the key recommendations of the OECD/DAC review).
C.2 Justice Sector and Anti-Corruption	
Adoption and submission to the Constituent Assembly of a draft Law relating to the creation of an interim judicial authority substituting the National Magistrates Council.	
Adoption of a Decision by the Minister of Justice creating a investigative unit specialized in financial and economic crimes.	Reinforcement of freedom of the press, printing and publishing: Revision of Decree-Law n° 115 in consensus with the entire media sector.

ANNEX 4: IMF RELATIONS NOTE

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

IMF Executive Board Concludes 2012 Article IV Consultation with Tunisia[75]

Public Information Notice (PIN) No. 12/96
August 3, 2012

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

On July 25, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tunisia.[76]

Background

The January 2011 revolution marked the beginning of an historical era for Tunisia. Following the overthrow of the former President, Tunisia has moved steadily forward with its democratic transition. The successful elections of a Constituent Assembly in October 2011 were a milestone. A new coalition government, led by the Islamic Party (Ennahda) with two secular parties, was formed. The constituent assembly is now preparing a new constitution, on the basis of which new general elections are scheduled to take place in March 2013.

While the political transition has continued to progress, Tunisia experienced a severe recession in 2011 amid domestic and regional turmoil. Real GDP contracted by 1.8 percent, reflecting a sharp decline in tourism and foreign direct inflows. As the result of the economic downturn and the return of Tunisian workers from Libya, unemployment soared to 19 percent in 2011, with youth unemployment at 42 percent. Tunisia's external position weakened, with the current account deficit widening substantially to 7.3 percent of GDP in 2011 and official reserves declining from US$9.5 billion at end-2010 to US$7.5 billion at end-2011. After decelerating to 3.5 percent in 2011, inflation accelerated to 5.7 percent in April 2012 (year-on-year).

[75] http://www.imf.org/external/np/sec/pn/2012/pn1296.htm

[76] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

The authorities implemented an expansionary policy mix to address social demands and support the economy. With an increase in current budget spending owing to an increase in the wage bill, larger food and energy subsidies, and new social measures, as well as increased capital spending, and notwithstanding a significant increase in revenue, the overall fiscal deficit widened to 3.5 percent of GDP in 2011 from 1.1 percent in 2010. As a result, following a decline in the last decade to 40 percent of GDP in 2010, the public debt ratio increased to 44.5 percent of GDP at end-2011. Monetary policy has been supportive of bank credit, with large liquidity injection and a reduction in the policy interest rate.

The economic downturn, particularly in the tourism sector, deteriorated the quality of the banks' portfolio. In response, the central bank relaxed its regulatory requirements to allow banks to reschedule loans for companies affected by the recession and injected large amount of liquidity in the banking system to help banks in an environment of declining assets performance. As a result, most banks became heavily dependent on central bank's refinancing.

Signs of a rebound have emerged in early 2012, with real GDP increasing by 4.8 percent (year-on-year) in the first quarter and tourism and FDI picking up. A recovery in real GDP growth would also be supported by a sizable growth-supporting fiscal expansion. However, risks to the short-term outlook are large and tilted to the downside, including a worse-than-anticipated recession in Europe which would depress exports, an escalation of domestic social tensions which would hamper foreign and domestic investment, and capacity constraints and delays in financing which could curb the envisaged growth-supporting fiscal stimulus. On the upside, a rapid stabilization of the situation in Libya could bolster investors' confidence.

Tunisia's medium-term economic growth potential remains favorable, but unleashing it requires a comprehensive package of structural reforms to foster private investment. Achieving higher and more inclusive growth over the medium term will be necessary to reduce high unemployment, especially among the youth, and address social and regional disparities. Real growth would gradually reach 6 percent by 2017 in a baseline scenario which assumes continued macroeconomic stability, improvement in governance and the business environment, reforms of the labor market and education system to address the labor skills mismatches, and a strengthening of the financial sector. Achieving higher growth will also require that large external financing, including FDI inflows and borrowing by the government and corporate sectors, can be mobilized.

Executive Board Assessment

Executive Directors noted that following Tunisia's political transition, the country faces pressing economic and social challenges, including elevated unemployment and regional disparities. Directors stressed the need to lay the ground for transforming the economy and promoting stronger and more inclusive growth. With the economic recovery facing risks from the unsettled political situation and the weak global environment, Directors saw a need to support economic activity while safeguarding macroeconomic stability.

Directors saw room for fiscal policy to support growth and employment in the short term. They generally considered the planned targeted expansion in public investment—while containing current spending—to be appropriate. In this regard, they welcomed the authorities' efforts to streamline public procurement and improve investment execution. Directors emphasized that fiscal consolidation should resume over the medium term to preserve fiscal and debt sustainability, and highlighted the need for a clear consolidation plan. They supported planned tax reforms to strengthen revenue and make the tax system more equitable and supportive of growth. They also emphasized the need to control medium-term public expenditures, including the wage bill, and to reform the subsidy and pension systems.

Directors supported the tightening of monetary policy to contain inflation, and welcomed the central bank's readiness to increase the policy rate if inflationary pressures persist. They underscored the importance of strengthening the institutional framework for monetary policy, as well as the coordination of monetary and exchange rate policies. Directors noted that greater exchange rate flexibility can help preserve foreign reserves. Directors emphasized the

need to ensure the central bank's independence for the conduct of monetary and exchange rate policies, as well as for banking supervision.

Directors encouraged the authorities to press ahead in addressing the banking sector vulnerabilities identified in the FSSA. They emphasized the need to decisively address high NPLs and bank recapitalization issues, as well as improve the governance of public banks. They also stressed the importance of aligning banking supervision with international standards. Directors encouraged the central bank to develop an exit strategy to unwind gradually its large liquidity support to banks while continuing to meet banks' liquidity needs.

Directors considered that comprehensive structural reforms are needed to reorient the Tunisian economy and harness its potential for higher and more inclusive growth. With the need to reduce unemployment, reform of the labor market and the education system will be key. Improving the business environment and governance will also be important to increase private sector investment. The development of high-value-added sectors will help absorb skilled labor. Directors highlighted the need to prioritize reforms while improving implementation capacity.

Tunisia: Selected Economic and Financial Indicators, 2008–13

	2008	2009	2010	Est. 2011	Projections 2012	2013
Production and income (percent change)						
Nominal GDP	10.9	6.3	7.8	2.2	8.6	8.2
Real GDP	4.5	3.1	3.0	-1.8	2.7	3.5
GDP deflator	6.1	3.1	4.7	4.1	5.8	4.6
Consumer price index (CPI), average	4.9	3.5	4.4	3.5	5.0	4.0
Gross national savings (percent of GDP)	22.1	21.9	21.6	16.8	18.1	18.9
Gross investment (percent of GDP)	25.9	24.8	26.4	24.1	25.1	25.9
External sector (percent change)						
Exports of goods, f.o.b. (in $)	26.6	-24.8	14.0	8.5	0.9	5.3
Imports of goods, f.o.b. (in $)	28.7	-21.9	15.9	7.7	2.2	5.6
Exports of goods, f.o.b. (volume)	5.5	-9.6	6.7	-1.5	-1.5	4.8
Import of goods, f.o.b. (volume)	7.3	1.0	-1.8	-6.0	5.0	6.5
Trade balance (in percent of GDP)	-8.9	-8.5	-10.3	-10.4	-11.1	-11.4
Current account, excluding grants (percent of GDP)	-3.8	-2.8	-4.8	-7.3	-7.0	-6.9
Foreign direct investment (percent of GDP)	5.7	3.3	3.0	0.9	2.5	2.8
Terms of trade (deterioration -)	0.1	7.6	-9.6	-4.0	5.1	1.4
Real effective exchange rate (depreciation -) 1/	-0.7	-1.1	-0.5	-1.8	...	...
Central government (percent of GDP, unless otherwise indicated) 2/						
Total revenue, excluding grants and privatization	23.8	23.1	23.3	24.7	23.8	23.0
Total expenditure and net lending	24.8	26.1	24.4	28.2	30.8	28.1
Central government balance, excluding grants and privatization	-1.0	-3.0	-1.1	-3.5	-7.0	-5.1
Central government balance, including grants, excluding privatization	-0.7	-2.7	-1.0	-3.2	-6.4	-5.0
Total government debt (foreign and domestic)	43.3	42.9	40.5	44.4	45.7	50.5
Foreign currency public debt (percent of total debt)	60.8	58.4	60.6	58.0	61.4	58.5
Money and credit (percent change)						
Credit to the economy	14.0	10.3	19.6	13.5	5.7	...
Broad money (M3) 3/	14.4	13.0	12.1	9.2	10.8	...
Liquidity aggregate (M4)	14.2	12.7	12.2	9.2	10.8	...
Velocity of circulation (GDP/M3)	1.62	1.52	1.46	1.37	1.34	...
Interest rate (money market rate, percent, e.o.p) 4/	4.90	4.10	4.12	3.05	...	...
Official reserves						
Gross official reserves (US$ billions, e.o.p)	9.0	10.6	9.5	7.5	8.2	8.7
In months of imports of goods and services, c.i.f. 5/	4.4	6.6	5.1	3.8	4.0	4.0
Total external debt						
External debt (US$ billions)	20.6	21.5	21.4	22.0	24.2	26.1
External debt (percent of GDP)	48.8	48.2	48.5	51.0	53.7	55.8
Debt service ratio (percent of exports of GNFS)	8.6	11.9	10.5	11.7	10.4	9.8
Financial market indicators						
Stock market index 6/	2,892	4,292	5,113	4,722	...	...
Memorandum items:						
GDP at current prices (TD millions)	55,296	58,768	63,380	64,802	70,402	76,182
GDP at current prices (US$ billions)	44.9	43.5	44.3	46.0	46.1	48.0
GDP per capita (US$)	4,346	4,171	4,199	4,320	4,284	4,409
Unemployment rate (percent) 7/	12.6	13.3	13.0	18.9	...	...
Population (millions)	10.3	10.4	10.5	10.7	10.8	10.9
Exchange rate: dinar/US$ (average)	1.23	1.35	1.43	1.41	...	...

Sources: Tunisian authorities; and IMF staff estimates and projections.

1/ Information Notice System.
2/ Excludes the social security accounts.
3/ Financial system (deposit money banks and development banks).
4/ 2011 data is the money market rate on 10/17/2011.
5/ End-of-year reserves over current year imports of goods and services.
6/ TUNINDEX. (1000 = 12/31/1997), with 2011 data at 10/17/2011.
7/ New series based on the ILO definition of the labor force.

ANNEX 5: BRIEF UPDATE ON IMPLEMENTATION OF THE REFORMS INTRODUCED BY THE 2011 GOVERNANCE AND OPPORTUNITY DPL

While most of the reforms will require more time for the population to achieve the full benefits of greater voice and accountability and increased economic opportunities, some quick results include:

Governance

- **The revision of the Law on Associations to remove discretion in the registration procedures:** While not a prior action for the GO DPL, the Bank strongly assisted the revision of this important law. As a result of this reform, nongovernmental organizations (NGOs), think tanks and other groups can now form easily and participate in public life, including fostering a debate on economic and social policies. Indeed, there has been a blossoming of such actors and a lively debate is now the norm across the country: Almost 1700 new NGOs have been registered between April 2011 and March 2012.
- **Adopt the Decree Law giving the public the right to access information held by public bodies the public has greater access to information, including economic and social data**: Starting from March 2011, the Ministry of Finance now publishes monthly data on budget execution. The backlog of annual reports of the Supreme Audit Institution have been published online in June 2011 and as of June 2012, on the Statistical Office website it is now possible to download the 4 most recent Labor Force Surveys (2007, 2008, 2009 and 2010), the most recent two household budget surveys (2000 and 2005), and a 22 percent sample of the 2004 Population Census, as well as substantial disaggregated data on trade and national accounts. In addition, with support by the World Bank, the Prime Minister's office organized a large international workshop on Access to Information in march 2012, to discuss how best to accelerate compliance with the new law. On this basis the Prime Minister (PM) has issued a circular, has prepared a detailed action plan for complementary actions, and is preparing to establish an Agency which will be charged to monitor progress in implementation and receive complaints. These reforms are part of the reform program supported by this programmatic series. In addition the team has been working on the demand side by working directly with CSOs to inform them and sensitize them on these issues, for instance by sponsoring the National CSOs Forum in May 2012, which brought together more than 200 NGOs from across the country and included a session on Access to Information and a session on new Social Accountability mechanisms in Tunisia.
- **The modification of the "Domain Names Charter" for the hosting of Internet websites, in order to simplify the procedures for the registration and hosting of Internet websites and eliminate the condition that the registrar is a Tunisian Internet Service Provider (ISP)** has led to an increase in excess of 90 percent in the number of websites .tn between end-December 2010 and end-June 2012
- **Revise the legal framework for public procurement to improve the efficiency and transparency of procurement procedures and to shorten the decision process without compromising quality**: Several changes were introduced to increase transparency and improve efficiency. As a result of the reform all invitations to bid, awards of contract and decisions of the complaint body (COSEM) are now published on the public procurement portal (www.marchespublics.gov.tn). In terms of efficiency, the length of the award process is now supposed to last approximately 2 to 4 months (instead of 3 to 6 months previously). In parallel, with technical assistance from the Bank (and the AfDB) the government has carried out a complete diagnostic of the procurement system using the OECD/DAC methodology and has devised an action plan to mitigate the major areas of weakness identified. The government is now

preparing a more structural reform of the procurement system, which is part of the reform program supported by this programmatic DPL series.

- **Launch a systemic, participatory, measurable and visible reform to simplify administrative procedures and red-tape and reduce discretion and arbitrariness, notably relating to the key aspects of the business environment:** The participatory regulatory simplification has been proceeding steadily, albeit with some delays. It is expected that out of 446 formalities identified in the tax and customs, only 7 percent will remain untouched, while approximately 8 percent will be eliminated, and a further 85 percent will be significantly simplified. The final report is being prepared and should be submitted to the Council of Ministers in November to approve the package of reforms. Based on this positive experience, the Government has now decided to extend the same 'guillotine' approach to all business formalities, which is being part of the reform program supported by this programmatic DPL series

Employment and Regional Development:

- **Establish a new regulatory framework for the National Employment Fund (approx 0.4% of GDP), starting with moving its management to the Ministry of Employment**: Following the removal of the Fund 21-21 from the Presidency to the Ministry of Employment, the latter has carried out a in-depth diagnostic of the Fund 21-21 with technical assistance from the Bank. The results of the diagnostic form the basis of the reforms supported by this programmatic DPL series, regarding the reform of the Employment Agency (ANETI), the consolidation of ALMPs (and in particular jobs insertion programs), and the participatory approaches to public works programs.
- **Design and implement a comprehensive unemployment support program to (i) enhance the employability of high-skilled youth and promotes their insertion into permanent employment, and (ii) to assist low skilled unemployed through cash-for-training and/or enhanced public works**: The 'AMAL' unemployment support program was launched in March 2011 and as of end-December 2011, approximately 130,000 unemployed graduates were receiving monthly financial support. However the limited capacity of the Employment Agency (ANETI) has resulted in the lack of serious implementation of the coaching and training components envisaged as part of the program. The government has reformed the AMAL program to substantially tighten eligibility criteria, with a view to reduce the number of beneficiaries to a more manageable level. In line with the reform of ALMPs supported by this operation, the government has also indicated that the AMAL program will be suspended in December 2013 (Decree 953, of August 3, 2012).

Financial sector:

- **The new regulatory framework on banks' corporate governance practices (including the introduction of criteria for selection of senior management and members of the board) has entered into force**: Sound corporate governance rules have been introduced in the banking sector, and their adoption is being monitored by the Tunisia Central Bank. *Inter alia*, as of July 2012 all banks are required to have at least two independent members on their board.

Social sectors:

- **Establish a mechanism of regular monitoring and evaluation by third parties of selected social programs and public services that will allow citizens to rate performance (e.g., using scorecards)**: The government has formalized the participatory evaluation tools via an online scorecards system, with Bank technical assistance. The First National Scorecard Results ("Le Barometre de Qualite et de Gouvernance"). This exercise covered all Public Services (10+) and was carried out between April 19 to May 4, 2012. Approximately 9,000 citizens provided feedback and the results have been published results at this site (http://www.consultations-publiques.tn). A Second National Scorecard exercise was carried out in June focusing on the – services/benefits from the National Health Insurance Fund, and details are also available on the same website. In addition the government is launching an in-person Scorecard through a rapid household survey (800 households in various regions) for institutionalization, i.e., every 6 months.

The government is now moving to institutionalize these participatory evaluations by mandating the internal control body to carry these out as part of its functions, and this reform is supported as part of the of this programmatic DPL series.

- **Institute a national outreach services policy to expand free access to care in underserved governorates for health and social services provided outside of traditional fixed facilities:** As of March 2012, the Ministry of Health has 89 mobile teams of personnel (medical and paramedical workers) rotating throughout 900 primary health centers nationwide. There are 13 mobile clinics that operate in poorer regions in 22 governorates, which include basic equipment, offer health education at schools and universities to youth and provide selected health services free of charge, covered by the National Social Security Fund and private health clinics. The Ministry of Social Affairs has recruited 100 additional social workers based in local communities, for a total of approximately 1600 community-based social workers (a density of nearly 1 per 7000 citizens, with plans to develop this further potentially in partnership with civil society). There are 24 mobile teams, at 1 per governorate, that focus on addressing social exclusion, and 28 mobile teams that provide social care including psychological, health and disability-related counseling. While the administration has disseminated guidance and information at the local level through regional bureaus, more effort is needed to more frequently and more widely publish online detailed performance indicators of outreach services. The Ministry of Health has published for the first time detailed statistical information on health care services and regional budget data as of December 2011, to which outreach services should be added in the future. The Ministry of Social Affairs has likewise planned for the monitoring and dissemination of more information online.

ANNEX 6: THE MAKING OF THE NEW CONSTITUTION IN TUNISIA[77]

The Constituent Assembly is organized in six commissions which are doing the bulk of constitutional drafting, and each has some twenty members drawn from all parties in the assembly roughly proportionally to the seats they control.

The six commissions will discuss, respectively: (i) The preamble, basic principles, and constitutional review; (ii) Rights and freedoms; (iii) Legislative and executive powers, and relations between the powers; (iv) Civil, administrative, financial, and constitutional justice; (v) Constitutional bodies to deal with media pluralism, financial regulation, politics and religion, and law enforcement and security; (vi) Local, regional, and municipal issues. The themes reveal that Tunisia's constitutional drafters are chiefly concerned with establishing a comprehensive legal framework for the republic, not with getting caught up in divisive political issues. The commissions are designed to isolate volatile topics from each other, allowing each group to work toward a stable consensus on a range of important issues.

Ennahda holds the chair of four of the commissions. The other two chairs come from the Congress for the Republic, a secular party in the governing coalition with Ennahda, and Ettajdid, a leftist opposition party. The chairs of each of the commissions form a coordinating drafting committee tasked with stitching the commissions' articles together into a complete draft. The Chair of the Assembly, Mustapha Ben Jaafar of the Ettakatol party, which is part of the governing coalition, is the chair of the coordinating committee, but he has a largely symbolic role in the drafting process.

Working from the commissions' articles, the coordinating committee will present a complete draft constitution to the Constituent Assembly. The draft will be adopted if it garners a two-thirds majority. If the draft fails, the coordinating committee will make revisions and send it back to the assembly. If it fails a second time, it will be submitted to popular referendum, at which point a simple majority would be enough to override the assembly and adopt the constitution. It is not clear what would happen if the draft fails the referendum; the assembly might disband or it might start the drafting process all over again.

[77] The Current Status of Constitution Making in Tunisia, Carnegie Endowment for International Peace. Blog by Duncan Pickard, April 19, 2012.
http://carnegieendowment.org/2012/04/19/current-status-of-constitution-making-in-tunisia

ANNEX 7: TUNISIA'S KEY SOCIAL INDICATORS [78]

Tunisia is on track to reach the MDGs with the exception of maternal mortality.

Over 98 percent of both male and female 6 to 11 year old children were enrolled in school in 2009/10 and based on recent trends it is expected that all students should complete primary school by 2015. Secondary net enrolment rate are similarly high, with 74 percent of boys and 81 percent of girls aged 12 to 18 in school. However, student learning outcomes remain low, with 61 percent of Tunisian students passing at least the 'low international benchmark' for mathematics grade 8, compared to an international mean of 75 percent. Similarly, only 31 percent of Tunisian students in science grade 8 pass the low international benchmark, compared to an international mean of 49 percent.

Health outcomes are relatively better than those found in other middle-income MENA countries. Progress has been made on infant and maternal mortality rates, malnutrition has dropped markedly, and HIV/AIDS prevalence is very low. However, mortality and health conditions in underserved regions lag considerably behind those in urban areas. Tunisians enjoy a relatively long life expectancy of 74 years. Although only 6 percent of children are stunted, they are over twice as likely to be stunted in rural areas as in urban areas (10 versus 4 percent, respectively). Between 2004 and 2008, Tunisia's Maternal Mortality Ratio (MMR) was estimated to be nearly 69 per 100,000 live births according to United Nations data (as compared to national estimates of 40 per 100,000 live births), or between two to four times that of most other middle income countries. Tunisia's infant mortality rate (IMR) of approximately 19 per 1,000 live births is near the global average and on the decline. It is estimated that approximately 80 percent of the population is enrolled in national health insurance and an additional 9 percent receive health cards covering free basic health services, but approximately 11 percent remain uninsured.

Access to basic socio-economic services (water, sanitation, electricity) is near universal in urban areas, but access to water and sanitation lags behind in underserved regions.

Tunisia has promoted gender issues and women's role in society to a notable extent overall. Shortly after its independence from France in 1956, Prime Minister Bourguiba introduced the Code of Personal Status, a series of laws aimed at giving women and men equal rights. The Code of Personal Status outlawed polygamy, required mutual consent for marriages and gave women constitutional equality, the right to vote, to travel and work without permission from their husbands, to file for divorce, to sign contracts and open bank accounts. A second wave of reforms in the early 1990s was led by women's organizations and successfully challenged discriminatory citizenship laws which prevented women married to non-nationals from passing their nationality to their children. Women have also benefited

Table 1. Key Social Indicators

Indicator	1990	2008	Likelihood of meeting MDG
Primary school enrollment rate (%)	93	98	YES
Progression to secondary school (% of primary)	38	84	n/a
Ratio girls-to-boys in primary & secondary school	85	103	YES
Prevalence of malnutrition (% stunting)	10.3	12	n/a
Infant mortality rate (per 1,000 births)	40	18	YES
Maternal mortality rate (per 100,000 births)	130	60	NO
Access to improved water source (%)	81	94	YES
Access to improved sanitation (%)	74	85	YES
Life expectancy at birth (all/women)	70/72	74/76	n/a

[78] Sources: TIMSS 2007 (http://timss.bc.edu/timss2007/index.html); Ministry of Education (2010), Annuaire Statistique 2009/10: http://www.education.gov.tn/article_education/statistiques/stat_education2010_fr.pdf; World Bank (2009), Who Pays: Out of Pocket Health Spending and Equity Implications in the MENA, Discussion Paper N. 58014, The World Bank, Washington D.C.; Ministry of Public Health/UNICEF (2006), Multiple Indicator Cluster Survey (MICS3), Tunisia.; UNICEF (2009), State of the World's Children Report, UNICEF, New York.

from Tunisia's high level of investment in education and made good progress in education (38 percent university enrollment compared to 25 percent of men, in 2007), wage parity, participation in politics and reduced fertility rates (by nearly half).

With 64 percent of the population living in cities or towns, Tunisia is more urbanized as compared to other Middle East and North Africa (MENA) countries.

ANNEX 8: A MORE CONSERVATIVE MACROECONOMIC SCENARIO

Given the substantial level of uncertainty surrounding the macroeconomic projections, a more conservative scenario has also been simulated based on continued weak demand from the euro zone and contested political process in Tunisia. The projections envisage a growth rate of 2.4 percent in 2012 and 3.5 percent in 2013 (Table A1). The depressed European market would continue affecting the export, notably the textile industry and the electric and mechanical industry, with slower recovery of tourism and FDI. High social tensions in the run-up to the elections period are also assumed to continue to affect economic performance and disrupt, albeit less frequently, economic activity and transport infrastructure, negatively affecting the performance of export sectors, notably mining (phosphates), chemical and manufacturing industries.

Under this scenario, as a result of pressure from the wage bill and food and fuel subsidies current expenditures would remain higher. Higher expenditure on wages and food and fuel subsidies, are mitigated by persistent challenges in implementation of public investment projects, resulting in a lower budget execution rate in 2012. This would at once result in slower GDP growth and also a slightly smaller fiscal deficit (unchanged as a percentage of the lower GDP). In 2013, the rise in current expenditures, progressive implementation of public investments, as well as continued pressure from wages and subsidies in the run up to elections are expected to pose a challenge to fiscal consolidation in 2013, with the fiscal deficit projected at 6.2 percent of GDP and at 5.7 percent in 2014.

The current account deficit would also be expected to remain larger during the next few years and f**inancing needs are expected to remain above 2011 in both 2012 and 2013, and only start decreasing thereafter.** The CAD is expected to widen to 7.8 percent of GDP in 2012, driven by the drop in manufacturing exports and the rise in commodities' import bill. In 2013, a gradual recovery in exports would be outpaced by the increase in imports (as the recovery in exports tends to be pr**e**ceded by growing imports in the same sector, notably inputs and equipment imports). The high level of current account deficits will be mitigated by gradual recovery of FDI, capital inflows (related to privatization and selling of assets in 2012-2013), and support from the international community. Yet the wider current account deficit and lower FDI inflows would imply a need for larger external official financing in 2013. Exports and tourism would be boosted by the European recovery in 2014. Under this scenario, international reserves are projected to decrease to 2.8 months of (GNFS) imports in 2012, and to marginally increase to reach 3.2 months of imports by 2014.

Overall the macro economic outlook would be more difficult, but still manageable. The deteriorating external balance and continued need for fiscal measures to boost the economy and mitigate social tensions would result in significant external financing needs in 2013. The authorities believe they have a range of options to face such an eventuality, and should the macroeconomic situation deteriorate substantially, they stand ready to request the support of an IMF program. The Tunisian recovery would be expected to consolidate from 2014, as improved confidence domestically as well as a recovery in the EU and in Libya could contribute to raise GDP growth to around 5 percent.

Table 1. Tunisia: Selected Macroeconomic Indicators under Prudent Scenario, 2009-2014

	2009 Act.	2010 Act.	2011 Act.	2012 Est.	2013 Proj.	2014 Proj.
National income and prices						
Real GDP growth rate (%)	3.1	3.1	-2.0	2.4	3.6	4.8
Nominal GDP (TND million)	58883	63522	65370	70955	76964	83482
Nominal GDP per capita (in U.S. dollars)	4180	4212	4350	4311	4455	4618
GDP inflation (%, period average)	3.7	4.7	5.0	6.0	4.7	3.5
Central government (percent of GDP)						
Total revenues and grants[1]	23.4	23.3	24.8	25.6	24.6	23.4
Total expenditure and net lending	23.3	26.1	28.0	31.9	30.3	28.8
Current expenditure	17.9	17.6	20.9	24.8	23.3	22.1
Capital expenditure	6.8	6.8	7.2	7.1	7.0	6.7
Overall balance before grants and privatization[1]	-3.0	-1.1	-3.5	-6.6	-6.2	-5.7
Money and credit						
Broad money (M2)/GDP	61.8	64.5	67.7	68.8	70.2	72.1
Broad money (M2, 12 months % change)	13.0	11.9	9.4	10.4	10.6	11.4
Credit to the economy (percent change)	9.9	18.4	13.5	7.0		
Interest rate (money market rate, in percent, e.o.p)	4.1	4.1	3.1			
Investment and savings						
Gross national savings (excluding grants)/GDP	21.6	20.8	15.9	15.2	16.8	19.0
Gross domestic investment/GDP	24.1	24.5	21.5	23.1	23.5	23.7
External sector						
Current account balance/GDP (excluding grants)	-2.8	-4.8	-7.3	-7.8	-7.5	-6.6
Gross international reserves (USD billion)	11.1	9.5	7.5	6.5	7.2	8.3
In months of GNFS imports	6.3	4.7	3.5	2.8	2.9	3.2
Exchange rate (TND per USD, period average)	1.35	1.43	1.41			
Debt stock						
Public debt (as percent of GDP)	42.8	40.4	44.0	46.0	48.3	50.3
Domestic debt	17.7	15.9	18.5	20.7	20.4	20.2

Sources: Tunisian Authorities and World Bank staff

Notes: 1. Includes the proceeds from the sale of confiscated assetts

Table 2. Tunisia: External Financing Needs under Prudent Scenario 2009-2014 (in US$ millions)

	2009 Act.	**2010** Act.	**2011** Est.	**2012** Proj.	**2013** Proj.	**2014** Proj.
Current account deficit	1234	2105	3371	3604	3645	3348
External medium and long term debt amortization	1347	1642	1940	2075	1788	1380
Total requirements	**2581**	**3747**	**5311**	**5679**	**5432**	**4728**
Grants	165	82	155	150	150	50
FDI and portfolio investments[1]	1525	1334	461	1180	1480	1982
Public borrowing	1549	1728	2348	2816	3823	3125
Of which:						
Official creditors	1315	1516	2142	1767	2536	1689
Private (incl bonds)	54	37	206	1049	1287	1436
Other capital flows n.i.e. (includes short term lending)	926	377	747	469	689	672
Total resources	**4164**	**3521**	**3710**	**4615**	**6142**	**5829**
Change in forex reserves	-1673	190	-1601	-1064	710	1101
Total financing	**2491**	**3712**	**5311**	**5679**	**5432**	**4728**

Sources: Tunisian Authorities and World Bank staff

Notes: 1. A foreign disinvestment in the Tunisiana cellphone operator in 2011 led to an exceptional capital outflow of USD600 million.

ANNEX 9: PUBLIC DEBT SUSTAINABILITY ANALYSIS

INTRODUCTION

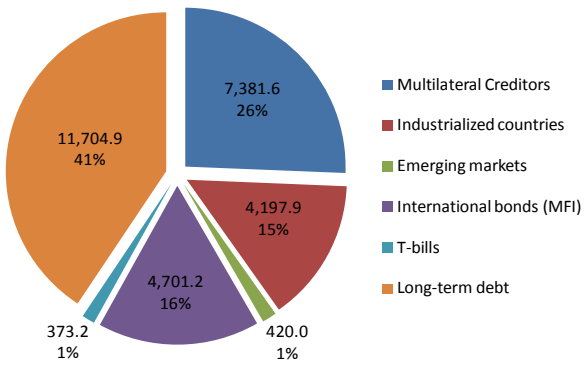
This public debt sustainability analysis of Tunisia considers the evolution of public debt indicators of the central government of Tunisia from 2012 to 2017. The evolution of debt indictors is projected under a baseline macroeconomic scenario, standard stress tests and alternative scenarios and through stochastic simulations. The analysis also assesses the fiscal space the government may use to finance public investment in the medium term.

The public debt sustainability of Tunisia has substantial risks and fiscal space for the government is limited. The public debt of Tunisia may increase in the event of lower than expected growth, a real exchange rate devaluation and the recognition of contingent liabilities, for example due to the recapitalization of domestic banks. In addition, prolonged large fiscal deficits will clearly put public debt on an unsustainable path. Stochastic simulations indicate that the public debt of Tunisia is not likely to exceed 60 percent of GDP in the medium term, but has a large probability of remaining above 50 percent of GDP. The analysis of the fiscal space concludes that the government strategy to sustain economic growth through increased public investment may not be viable if private investment and employment do not increase as well and if public debt will exceed 50-55 percent of GDP.

BACKGROUND

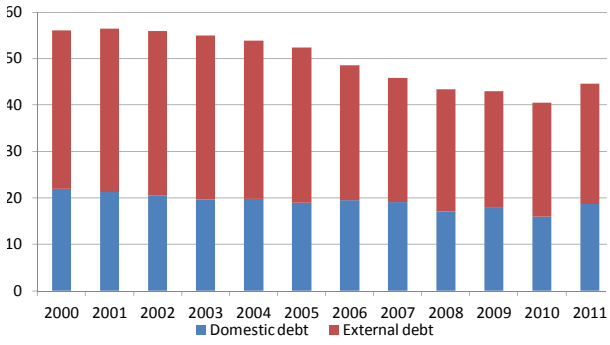
The debt stock of Tunisia amounts to 44.5 percent of GDP at end-2011 and it is mainly foreign-owed and long term. At end 2011, the public debt of the central government of Tunisia amounted to TND28.8 billion (US$19.2 billion). This debt is 58 percent owed to foreign creditors (see Figure 1). The debt stock of Tunisia has decreased from 56.1 percent of GDP in 2000 to 40.5 percent in 2010 before increasing to 44.5 percent at end-2011 (Figure 2). Short term debt, entirely constituted by short term treasury bills, represents only 1.3 percent of total public debt at end-2011.

Figure 1. Public Debt at end-2011 by Creditor Groups (In billions of TD)



Source: Ministry of Finance

Figure 2. Total Public Debt, 2000-2011 (In percent of GDP)



Source: Ministry of Finance

Debt guaranteed by the government amounts to an additional 10.2 percent of GDP at end-2011. External guaranteed debt amounts to TND6.6 billion and domestic guaranteed debt to TND0.8 billion. Guaranteed debt is limited to state owned enterprises (SOEs) and all loans have long term maturity. The government considers that 30 percent of domestic guaranteed debt was issued to SOEs which are not financially viable. As of June 2012 no guarantee has been called.

Economic growth has mainly contributed to the decrease of the stock of debt over time. During the period 2002-2007 the public debt of Tunisia has decreased rapidly, mainly thanks to an average

real growth rate of 4.8 percent and the appreciation of the real exchange rate. During this period, growth has contributed to reducing the debt to GDP ratio by 14.3 percent and the real exchange rate by 6 percent. The debt ratio has then continued to decrease in the following years, but at a slower pace, before increasing in 2011 (Table 1).

Table 1. Debt Decomposition, 2001-2011

	2002-2007	2008-2011	Total
Cumulative Change over the period	-10.7	-1.2	-11.9
Primary balance	0.6	-0.3	0.3
Contribution from real interest rate	6.4	0.4	6.7
Contribution de la croissance réelle	-14.3	-3.5	-17.8
Contribution from real GDP growth	-6.0	5.2	-0.8
Other factors	2.6	-3.0	-0.4

Source: Ministry of Finance.

In 2011 Tunisia's economy has been hit by three major shocks. First, the domestic political change has been accompanied by disruption of economic activity and an increase in social outlays by the new interim government. Second, the upheaval and political change in neighboring Libya, one of the main trading partners and source of workers' remittances. Third, the intensification of the economic crisis in the Euro Area, the main destination of Tunisia's exports, especially in France and Italy.

The three shocks have impacted on economic activity, fiscal revenue and expenditure. In 2011, GDP growth has contracted by 1.8 percent. Public expenditure, excluding interest payment has increased to 26.8 percent of GDP, up 4 percentage points compared t 2009. Following the revolution, the interim government prepared a supplementary budget in June 2011 to account for the fiscal impact of the revolution and the need for additional measures to alleviate social unrest and boost economic growth. The revised fiscal deficit was expanded from 2.5% (planned in the original 2011 budget) to 5.1 percent, but lower budget execution has contained primary deficit to 1.3 percent of GDP. Fiscal revenues also increased in 2011 thanks to a one-off increase of non-tax revenues as the government called in several years of overdue dividends from the Central Bank and various SOEs. Tax revenue remained constant in percentage of GDP at 20.5 percent.

Domestic and external borrowing roughly doubled in 2011. On gross terms, domestic borrowing doubled compared to 2010 to TND1.3 billion. Also gross external borrowing doubled compared to 2010, to TND2.5 billion. Most of domestic debt financing was long term. A large portion of the external borrowing was used to repay debt coming due.[79] This increase in gross domestic borrowing from less than 1.9 percent of GDP in 2010 to 3.8 percent in 2012 may also have put some pressure on domestic interest rates. Interest rates on BTA increased from an average of 5.1 percent in 2010 to 6.0 percent in 2011.The fiscal deficit in 2011 was mainly financed through domestic borrowing, which put some pressure on domestic interest rates. Net domestic financing amounted to TND1.3 billion, three times as much as net external debt financing.

The current account balance widened in 2011 due to a sharp reduction in tourism receipts, merchandise exports and remittances. The 2011 pressure on the balance of payment was considered as a temporary economic shock by the government. Therefore the Central Bank of Tunisia (BCT) has

Hence, in net terms the fiscal deficit in 2011 was mainly financed through domestic borrowing as net domestic financing amounted to TD1.3 billion, three times as much as net external debt financing.

used some of its reserves to limit the rate of depreciation resulting from the larger current account deficit.

MACROECONOMIC FRAMEWORK FOR 2012-2017

Growth is expected to partially recover in 2012 and reach 4.8 percent in the medium term, above the historical average. After the recession in 2011, economic growth rate is expected to be moderate, at 2.4 percent, in 2012, due to lack of resumption of economic growth in the Euro Area, low demand for tourism and continued strikes. Growth is expected to pick up thanks initially to the increase of public investment, followed by an increase in private investments and the resumption of merchandise exports and tourism in the medium term (Figure 3).

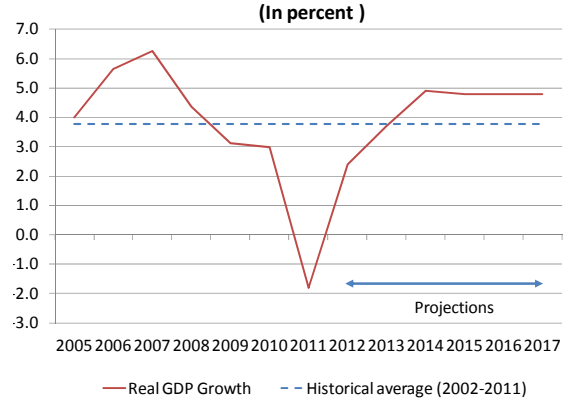
Inflation will remain close to 4 percent, slightly above the historical average. The inflation rate declined in 2011 as a consequence to the recession and low domestic demand. The BCT has provided a significant amount of liquidity to the banking sector in the form of short-term loans during 2011 to boost the provision of credit to the private sector. The expansionary monetary policy is expected to continue also in 2012, although the CBT recently increased the money market interest rate. High oil prices and the resumption of domestic demand, also sustained by large fiscal subsidies (see below), are expected to push inflation to just below 7 percent in 2012, up from less than 4 percent in 2011. Inflation is expected to lower to 4.0 percent, when BTC will gradually tighten interest rates from 2014, in line with the assumptions about global interest rates (Figure 4).

The government is expected to continue provide a fiscal stimulus to the economy in 2012, before gradually reduce the fiscal deficit in line with historical average. Fiscal revenues are expected to decrease by 3 percentage point of GDP in 2012, mainly due to a decrease in lower corporate profits and lower profits from SOEs, caused by the recession of the previous year. Tax and non-tax revenues are then expected to gradually increase but to total below 23 percent of GDP in the medium term. Expenditures will remain at 26.8 percent of GDP as in 2011. Current expenditure will further increase to 23.0 percent of GDP in 2012, more than 5 percentage points of GDP higher than in 2010, mainly due to (i) food and oil price subsidies, (ii) welfare benefits, (iii) transfer to local communities, and (iv) an increase of wages and salaries. Investment expenditure will also be scaled up to 8.8 percent of GDP in 2012, up from 6.5 percent in 2010 and 7.2 percent in 2011. Public expenditure will gradually decrease to 23 percent in the medium term. In 2012, the resulting overall deficit is expected to reach 6.6 percent of GDP and the primary fiscal deficit to amount to 4.8 percent of GDP. With the progressive reduction of expenditure, the primary deficit will then reach 0.5 percent of GDP, in line with historical average (Figure 5).

The deficit will be financed mainly from external sources, including through the resumption of international bonds, last issued in 2007. Domestic debt issuance, after an increase in 2011, is expected to remain at about 1.5 percent of GDP, a level that the government considers consistent with the investment capacity of commercial banks and that will avoid to put pressure on domestic interest rates. The average interest rate on domestic debt is expected to increase from 3.9 percent in 2012 to 4.6 in the medium period, below the peak of 6 percent reached in 2011. External financing will amount to about 90 percent of gross financing needed in 2012. The interest rate on external debt is expected to average at below 3 percent (Figure 6). The government is planning to borrow from multilateral institutions, including IBRD and the AfDB and to issue an international bond whose terms will be enhanced thanks to a guarantee offered by the US Government. At the beginning of 2012, the Government already issued through a private placement to the Government of Qatar bonds amounting to US$500 million. In addition, in 2012, exceptional financing amounting to about TND2.2 billion is expected to be obtained by the privatization of SOEs and the sale of assets belonging to the family of the former exiled president.

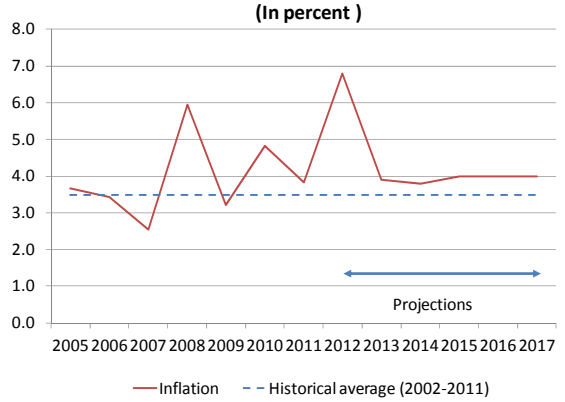
The current account deficit will widen slightly in 2012 and will remain above 7 percent of GDP during the projection period. The continued economic crisis in the Euro Area will depress demand for Tunisian goods in 2012, while the fiscal stimulus will increase imports. The current account deficit will reach 7.3 percent in 2012, slightly up compared to 2011. From 2013 onwards, stronger domestic demand and economic development will further increase imports. The demand for imports will also rise as Tunisia shifts its export structure from low-value-added sectors to high-tech sectors, which rely on raw or semi-processed imports. After 2014 it is expected that a resumption of tourism and remittances will improve the current account deficit to 7.3 percent of GDP. The BCT will continue implement a managed float exchange rate regime against a basket of currencies, mainly the U.S. dollar and the euro. In 2012, the BTC will allow the exchange rate to depreciate in order to maintain reserves above 3 months of imports. In the medium term, the real exchange rate will continue to depreciate moderately (Figure 6).

Figure 3. Real GDP Growth, 2005-2017
(In percent)



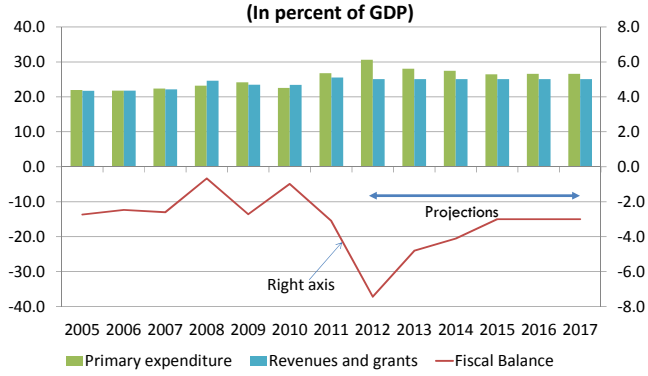
Sources: Ministry of Finance and World Bank staff's estimates and projections.

Figure 4. Inflation, 2005-2017
(In percent)



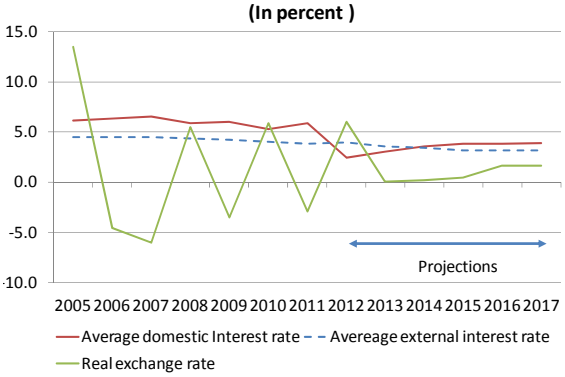
Sources: Ministry of Finance and World Bank staff's estimates and projections.

Figure 5. Fiscal Balance, 2005-2017
(In percent of GDP)



Sources: Ministry of Finance and World Bank staff's estimates and projections.

Figure 6. Nominal Interest Rates and Real Exchange Rate Change, 2005-2017
(In percent)



Sources: Ministry of Finance and World Bank staff's estimates and projections.

The prudent (baseline) macroeconomic framework is subject to a number of downside risks. The macroeconomic framework assumes that public investment earlier and private investment later will help Tunisia achieve economic growth higher than the past average growth. It also assumes that the government will be able to wind down the initial fiscal stimulus. The cost of borrowing of the government is expected to remain low, especially on external debt, which will provide the bulk of financing. Availability of foreign financing will also maintain the exchange rate stable. However, achieving high and prolonged economic growth may prove elusive, especially if key export markets remain in crisis and if public investment will not entice private investment and raise employment.

Reversing wage increases and subsidies will be politically costly. As will be scaling back infrastructure investment. The government is already financing part of pension payments and health benefits. These expenditures risk to permanently increase the budget deficit. Larger budget deficit will in turn impact negatively on the cost of financing, further increasing the pressure on fiscal sustainability.

The authorities' macro framework envisages higher growth and more rapid fiscal consolidation in the medium term. As discussed in Section II of the main document, according to the medium term framework adopted by the government in 2012 public expenditure will exceed 30 percent of GDP and the primary deficit will reach 4.8 percent of GDP. The primary deficit will then decrease rapidly to 3.6 by 2014 and eventually decline to less than 2 percent GDP by 2016, thanks to a reduction in expenditure. Revenues are expected to decrease gradually from 25 percent of GDP in 2012 to 23 percent of GDP in 2014 reflecting the lower non tax revenues from the sale of assets confiscated to the ex-President Ben Ali and his family in future years. The government also projects a faster recovery in 2012 and aims at achieving growth above 6 percent in the medium term.

FISCAL SUSTAINABILITY ANALYSIS

PRUDENT SCENARIO (BASELINE):

The public debt of Tunisia will continue its upward trend, started in 2011, and reach 47 percent of GDP in 2012, further increase to 47.4 percent in 2014, before declining in the medium term. The large fiscal deficit and the depreciation of the Dinar will push the debt-to-GDP ratio up 2.4 percentage point of GDP compared to 2011. More moderate fiscal deficit will push the debt ratio further up until 2014. Under the baseline scenario, high economic growth, well above historical average, fiscal consolidation, low cost of financing, stable exchange rate and moderate inflation will put the debt ratio on a downward trend in the medium term (Table 2 and Figure 7).

The government will face large financing needs from 2012 to 2014. Gross financing needs are expected to reach 10 percent of GDP in 2012, compared to 6.5 percent in 2011 (Table 2 and Figure 7). In 2012, the government expects to finance more than 3 percent of GDP through the use of the proceeds of the partial privatization of *Tunisie Télécom* in 2006 and the sale of assets belonging to the former ousted president and his family. Financing needs are expected to be met mainly through long term external borrowing, which will maintain low the risks of rollover and refinancing. From 2015, the gross financing needs of the government will return to the level prior to 2011.

SENSITIVITY ANALYSIS

The sensitivity analysis considers the evolution of the public debt-to-GDP ratio under standard alternative scenarios, bound tests and stochastic simulations, based on country specific shocks. The analysis highlights substantial upside risks for the evolution of the solvency and liquidity indicators in the event of exogenous shocks and if the government cannot reduce the fiscal deficit in the medium term. A higher debt stock could weigh negatively on the capacity of the government to stimulate the economy and on fiscal sustainability. Under most alternative scenarios, the debt stock is expected to increase indefinitely. Under the most severe bound tests, the debt ratio will reach 55-60 percent of GDP, or 8-13 percentage points above the peak level under the baseline scenario (Figure 7).

Under a scenario of low growth or high fiscal deficits the debt ratio will continue to increase over time. If the fiscal stimulus implemented by the government will fail to generate the expected growth rate, the debt ratio will surpass and remain above 50 percent of GDP in 2015. Also in case the government will not be able to reduce fiscal deficit compared to 2012, the debt ratio will permanently

increase and reach 60 percent of GDP by 2017, even if the high growth rates expected under the baseline scenario are achieved.

Public debt of Tunisia will be vulnerable to a depreciation of the exchange rate. As the financing needs of the government are expected to be met mainly with external borrowing, foreign-currency denominated public debt of Tunisia will increase from 58 percent at end-2011 to 65 percent in 2017. A 30 percent depreciation of the Dinar vis-à-vis other major currencies, mainly the U.S. dollar and the euro, will push the debt ratio to 60 percent of GDP.

The realization of contingent liabilities could also increase public debt above 55 percent of GDP. The recent FSAP concludes that in the event of a negative shock to the economy a number of banks will not meet the capital adequacy ratio. The FSAP quantifies the recapitalization needs in about 5 percent of GDP. The government may also need to service about 30 percent of domestic debt contracted by SOEs, about TND300 million, which was guaranteed by the central government.

Other shocks do not signal high risk for debt sustainability. A limited increase in borrowing cost, a small deviation of the primary fiscal balance compared to the baseline or a combination of small permanent deviation from growth, fiscal deficit and cost of financing will not generate large increases in the debt to GDP ratio (Figure 7).

The standard stress tests highlight the risk that the public debt ratio could increase substantially if the benign assumptions underpinning the baseline will not materialize. Lower growth, large and prolonged fiscal deficit, large exchange rate depreciation and the realization of contingent liabilities represent the most important risks. However, the standard stress tests are exogenous shocks that do not account for interactions between the variables underlying the debt dynamics. In addition, these shocks cannot give a sense of the probability associated with a certain increase in the level of the debt ratio.

Stochastic simulations applied to the public debt dynamics indicate that the public debt of Tunisia will likely remain below 60 percent of GDP during the projection period. The stochastic simulations project the possible realizations of the debt ratio, depending on (i) the interactions among real growth, domestic and foreign real interest rate and the real exchange rate, (ii) shocks to those four variables, which are calibrated on the Tunisian economy and assumed to be jointly normally distributed, and (iii) the assumed baseline fiscal policy[80] . This probabilistic approach allows to more formally define the uncertainty surrounding the projections of the variables underlying the debt dynamics. According to the simulations, the public debt of Tunisia will remain, over the projection period, between 36 and 57 percent of GDP with a 90 percent probability (Figure 8). Therefore, under the assumptions that shocks to the Tunisian economy will not be different from those that took place in the past, the public debt of Tunisia is unlikely (i.e. with a probability of less than 5 percent) to exceed 60 percent of GDP.

The stochastic simulations also indicate that there is a probability close to 25 percent that the debt to GDP ratio will remain above 50 percent in the medium term (Figure 9). Most alternative scenarios and bound test described above imply that the public debt will reach 50-60 percent of GDP in the event of shocks (to growth, real exchange rate or contingent liabilities) or as a result of protracted high fiscal deficits. The stochastic simulations provide a better-defined measure of uncertainty, indicating that there is a probability of about 25 percent that public debt will surpass 50 percent of GDP.

In the scenario formulated by the authorities, public debt is likely to exceed 50 percent with a probability of more than 40 percent. Compared to the prudent (baseline) scenario, the government

[80] The simulations do not incorporate a fiscal reaction function; that is possible corrective measures that the government may undertake as a result of debt surprises.

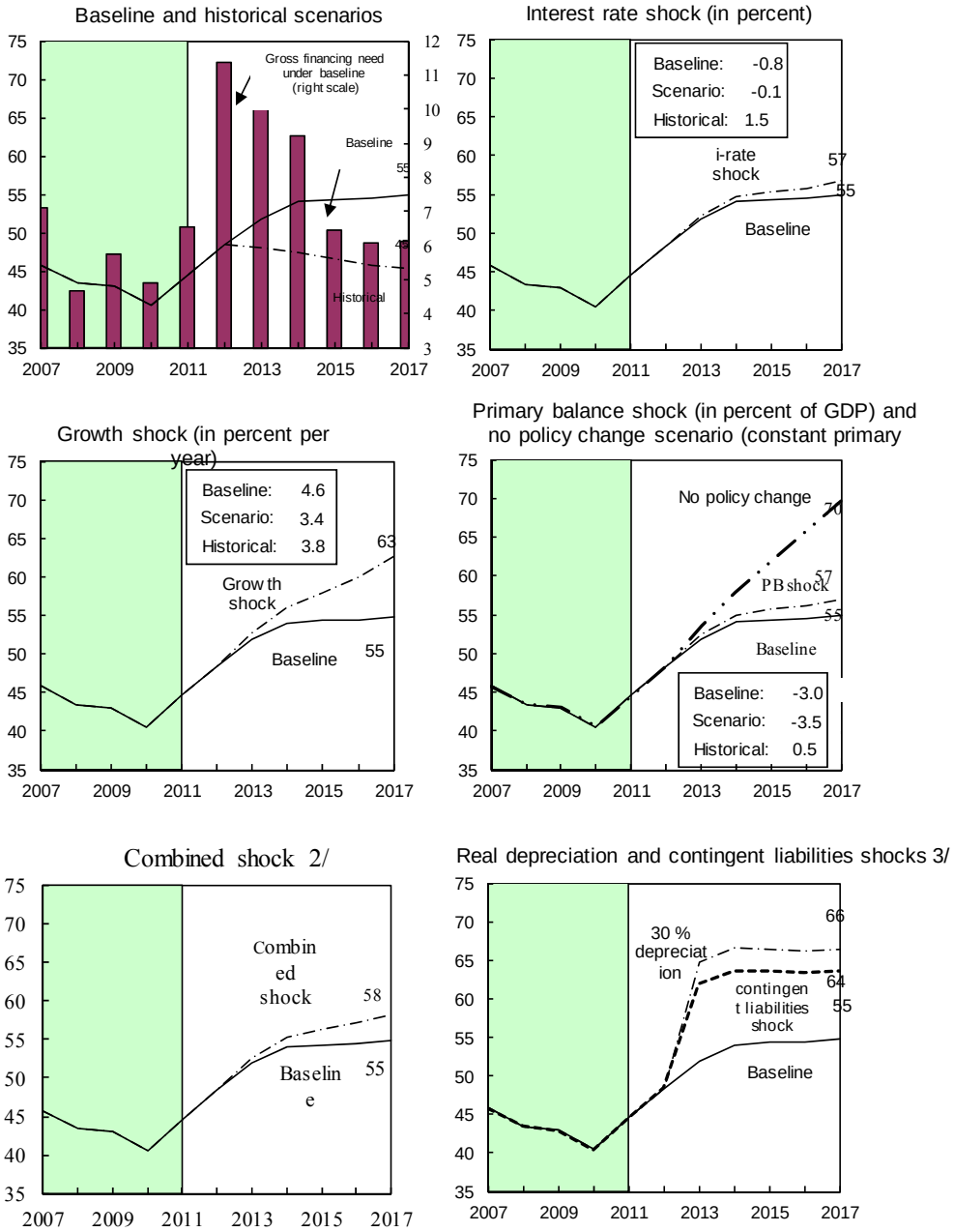
assumes higher fiscal deficits in 2012-17 and higher growth in 2015-17. Under these assumptions, public debt is expected to peak at just above 50 percent in 2014, and then gradually decline to below 49 percent by 2017. Under the government's scenario, the standard stress tests indicate that key risks will still derive from lower growth, higher prolonged fiscal deficits, exchange rate depreciation and the realization of contingent liabilities. Stochastic simulations associate a probability of 40 percent that public debt will exceed 50 percent of GDP during the projections period. As in the prudent (baseline) scenario, the probability that the debt will be above 60 percent remains low.

Table 2. Tunisia: Public Sector Debt Sustainability Framework, 2007-2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 10/
Baseline: Public sector debt 1/	45.8	43.4	42.9	40.5	44.6	**48.4**	**51.9**	**54.0**	**54.3**	**54.4**	**54.9**	**-1.7**
o/w foreign-currency denominated	26.7	26.4	25.1	24.6	25.8	28.8	30.2	30.3	29.5	31.6	33.7	
Change in public sector debt	-2.8	-2.4	-0.5	-2.5	4.1	3.8	3.5	2.1	0.3	0.1	0.5	
Identified debt-creating flows (4+7+12)	-4.0	-2.4	-0.2	0.0	3.4	0.5	2.4	1.1	-0.7	-0.7	-0.7	
Primary deficit 2/	-0.6	-2.0	0.4	-0.9	1.3	6.1	4.4	3.9	2.2	2.2	2.2	
Revenue and grants	23.0	25.2	23.8	23.5	25.5	24.5	23.5	23.5	23.5	23.5	23.5	
Primary (noninterest) expenditure	22.4	23.2	24.2	22.6	26.8	30.6	27.9	27.4	25.8	25.8	25.8	
Automatic debt dynamics 3/	-3.4	-0.4	-0.6	0.9	2.1	-2.4	-2.0	-2.7	-2.9	-2.9	-2.9	
Contribution from interest rate/growth differential 4/	-1.6	-2.3	-0.6	-1.3	1.1	-2.4	-2.0	-2.7	-2.9	-2.9	-2.9	
Of which contribution from real interest rate	1.2	-0.5	0.7	-0.2	0.3	-1.5	-0.4	-0.4	-0.5	-0.5	-0.5	
Of which contribution from real GDP growth	-2.8	-1.8	-1.3	-1.2	0.7	-1.0	-1.7	-2.3	-2.4	-2.4	-2.4	
Contribution from exchange rate depreciation 5/	-1.7	1.9	0.0	2.2	1.1	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	-3.1	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	-3.1	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 6/	1.2	0.0	-0.2	-2.4	0.7	3.3	1.1	1.0	0.9	0.8	1.2	
Public sector debt-to-revenue ratio 1/	198.8	172.1	180.7	172.3	174.6	197.6	220.6	229.7	230.8	231.3	233.4	
Gross financing need 7/	7.1	4.7	5.7	4.9	6.5	11.4	10.1	9.2	6.4	6.1	6.1	
in billions of U.S. dollars	2770.4	2089.4	2474.4	2169.5	2992.0	5064.2	4624.8	4449.3	3276.1	3260.6	3434.2	
Scenario with key variables at their historical averages 8/						**48.4**	**47.9**	**47.3**	**46.6**	**45.7**	**45.2**	**0.1**
Scenario with no policy change (constant primary balance) in 2012-2017						**48.4**	**53.6**	**57.9**	**61.9**	**65.7**	**69.7**	**-2.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.3	4.4	3.1	3.0	-1.8	2.4	3.7	4.9	4.8	4.8	4.8	
Average nominal interest rate on public debt (in percent) 9/	5.3	5.0	4.9	4.6	4.6	3.4	3.2	3.2	3.2	3.2	3.2	
Average real interest rate (nominal rate minus change in GDP deflator, in p	2.8	-0.9	1.7	-0.2	0.8	-3.4	-0.7	-0.6	-0.8	-0.8	-0.8	
Nominal appreciation (increase in US dollar value of local currency, in perc	6.7	-7.1	0.1	-8.4	-4.1	…	…	…	…	…	…	
Inflation rate (GDP deflator, in percent)	2.6	5.9	3.2	4.8	3.8	6.8	3.9	3.8	4.0	4.0	4.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	9.2	8.1	7.4	-3.8	16.5	17.0	-5.4	2.9	-1.4	5.4	4.8	
Primary deficit	-0.6	-2.0	0.4	-0.9	1.3	6.1	4.4	3.9	2.2	2.2	2.2	

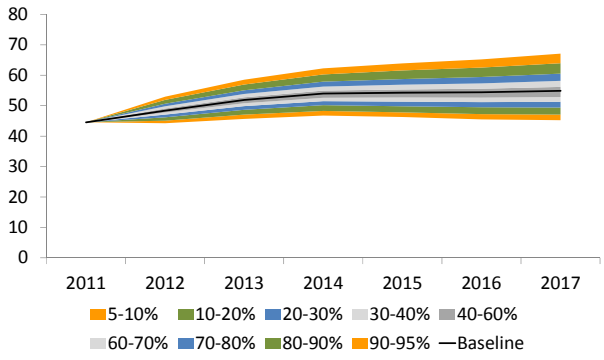
1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Exclude capital revenue, considered as a financing item under privatization receipts.
3/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
4/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
5/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
6/ For projections, this line includes exchange rate changes.
7/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
9/ Derived as nominal interest expenditure divided by previous period debt stock.
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 7. Tunisia: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



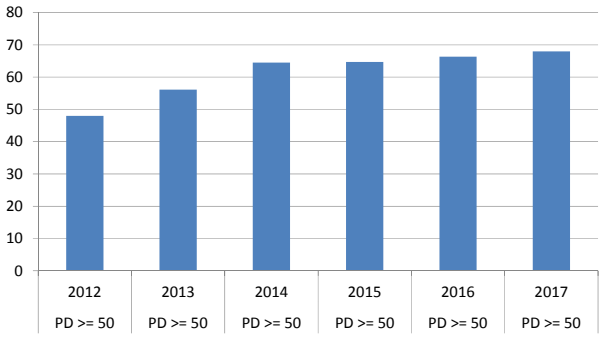
Sources: Tunisian Authorities and World Bank staff estimates and projections.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also show n.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, grow th rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, w ith real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 8. Distribution of Public Sector Debt, 2011-2017



Sources: Ministry of Finance and World Bank staff's estimates and projections.

Figure 9. Probability of Public Debt higher than 50 percent of GDP, 2011-2017



Sources: Ministry of Finance and World Bank staff's estimates and projections.

FISCAL SPACE TO FINANCE PUBLIC INVESTMENTS

Could Tunisia achieve higher growth through debt-financed public investments? The government intends to scale up investment in infrastructure in 2012-2014 to boost growth. The success of the government will depend on (i) the capacity of the government to finance higher deficits without increasing the cost of financing or crowding out private investment; (ii) the effect of higher public investment on growth; and (iii) the complementarity of public and private investment.

In the event of shocks or larger fiscal deficits, the public debt of Tunisia will reach indicative debt level thresholds for emerging markets[81]. Under the baseline scenario, and also under the scenario formulated by the government, the public debt of Tunisia will remain below the debt range that corresponds to long-term equilibrium level in absence of crisis events, i.e. a level of debt that could be indefinitely sustained, given the typical fiscal reaction of middle income countries to increase in debt levels beyond this range. However, as noted above, both the baseline and the government scenarios are premised on very benign economic and financial conditions and assume that the government will be able to reduce the fiscal deficit in the medium term. Under the most extreme scenarios, the public debt ratio will reach or, in one case exceed, the upper bound of the equilibrium level (Figure 10). These indicative thresholds are estimated only with respect to solvency (i.e. considering only debt crisis), and do not take account of liquidity/rollover risks. Therefore a country will generally remain well below those debt limits to avoid that liquidity risk will increase financing costs and compromise debt sustainability.

The comparison of different scenario with the indicative debt ranges for MICs indicates that the government has only limited fiscal space to finance investments in the medium term. This fiscal space will depend on the capacity of the government of signaling that fiscal deficits will be decreased in the medium term and that debt will not increase indefinitely, even in the event of shocks.

The fiscal space will also depend on the capacity of the government to boost growth through public investment. An econometric analysis indicates that private investment and employments and not public investment are the factors of production that increase the most long-term growth (see Appendix I). In addition, debt-financed investment reaches a limit when public debt exceeds 50-55 percent of GDP (Appendix II).

[81] See "Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis", IMF, August 2011.

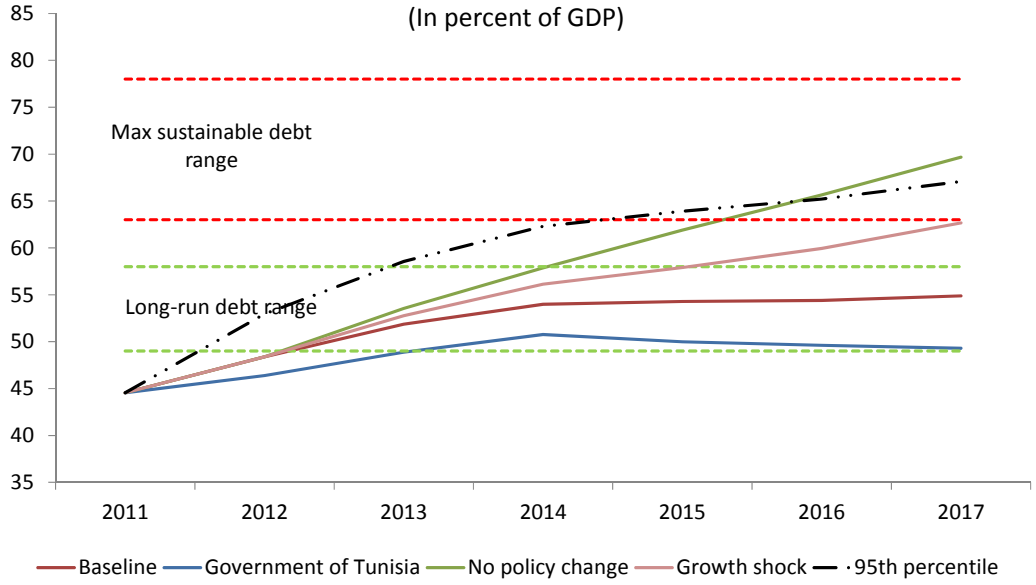
Per capita long-run GDP growth is positively associated with higher private investment and higher employment, while it is negatively associated with public investment. An econometric analysis has considered a production function which distinguishes, as factors of production, public and private investment, human capital and employment. The analysis finds that private investment and employment are the factors of production which impact the most on output growth, while the effect of public investment is negative (Appendix I). The analysis, which is based on a sample covering data from 1980 to 2009, signals that high growth rates will not be achieved in the long-run unless the government introduces reforms that favor private investments and create employment.

A structural decomposition of growth in living standards in Tunisia in the past 29 years into contributions from long run equilibrium determinants reveals the effect of private investment. Real per capita growth over the period 1981-2009 averaged 2.4 percent. Private investment contributed 1.5 percent, while public investments 0.3 percent. The participation rate of the labor force had a negative small contribution of 0.3 percent, due to a slight decline over the period of the employees with respect to the total working-age population (Appendix I).

Debt financing will constrain total investment if public debt reaches 50-55 percent of GDP. An econometric analysis, based on a data from 1970 to 2007, finds that total investments will decrease if public debt exceeds 50-55 percent of GDP, according to model specifications. The analysis fails to find evidence of crowding out effects, i.e. of negative effects on investment of an increase in the cost of financing, but instead points out a debt threshold effect, which is consistent with the level of public debt-to GDP ratio which will result under the standard scenarios and bound tests reported above, and with the level of debt at the 95-th percentile of the stochastic simulations of debt dynamics (Figure 10).

Fiscal space to finance public investment is limited. A deviation from the benign assumptions of the baseline scenario caused by shocks that are consistent with those Tunisia has experienced in the past will quickly exhaust the positive effect of public debt financing on investment. In addition, positive output growth will not be generated by public investment alone, but by the capacity of the government to boost private investment and employment.

Figure 10. Public Debt of Tunisia and Long-run Debt and Maximum Sustainable Debt Ranges for Emerging Market Economies
(In percent of GDP)



CONCLUSIONS

Under the baseline scenario, the public debt of Tunisia remains at a manageable level. The public debt of Tunisia has declined substantially over the past 10 years. Since 2011, the downwards trend has been reversed. At end-2011, the public debt amounted to 44.6 percent of GDP and it is projected to further increase to 47.0 percent at end-2012. Public debt is expected to remain at around 47 percent of GDP until 2014 and then decline thanks to high growth, fiscal consolidation, low cost of financing and stable exchange rate and inflation.

Standard alternative scenarios and stochastic simulations point to a number of downside risks for debt sustainability. Lower growth, prolonged large fiscal deficits, exchange rate devaluation and the recognition of contingent liabilities will increase public debt above 50-55 percent of GDP. Stochastic simulations estimate that the public debt of Tunisia has a probability of about 25 percent of remaining above 50 percent of GDP over the projection period, but a probability of less than 5 percent of exceeding 60 percent of GDP.

Fiscal space to finance infrastructure investment is limited for the government. Comparison with indicative ranges for emerging markets indicates that, in the event of extreme shocks, the government will quickly exhaust the capacity to finance investments without raising sustainability concerns. Continued large fiscal deficits, in particular, will put Tunisia's public debt on a clearly unsustainable path. In addition, the government strategy of boosting growth through public investment is not supported by empirical analysis, unless the government will also entice higher private investment and employment. Lastly, a strategy to finance public investment trough debt, without fiscal consolidation, could negatively impact on total investments if debt exceeds 50-55 percent of GDP.

Appendix I: The investment-growth nexus

The theoretical framework within which we analyze the determinants of long run growth in living standards is based on the neoclassical growth model of a closed economy with an exogenous saving rate due to Solow (1956). Following Mankiw, Romer and Weil (1992), the growth model is adapted to an open economy case by treating the investment rate as exogenous, and it distinguishes between physical capital and human capital. Following Aschauer (1989), the model further distinguishes between private physical capital and public physical capital. The empirical framework considers the short and long run equilibrium determinants of per capita GDP growth in a vector error correction model (VECM). The VECM allows to differentiate the deviation of the growth rate of output per capita from its unconditional mean of g due to short run deviations (inclusive of autoregressive processes and exogenous determinants) and the deviation of the level of output per capita from its long run equilibrium value. It also avoids problems related to endogeneity of the regressors. In the VECM, changes of output per capita are as follows

$$\Delta \ln \frac{Y_t}{N_t} = g + \sum_{j=1}^{J} \phi_j \left(\Delta \ln \frac{Y_{t-j}}{N_{t-j}} - g \right) + \sum_{k=1}^{K} \theta_k \left(X_{k,t} - \overline{X_k} \right) + \beta \left(\ln \frac{Y_{t-1}}{N_{t-1}} - \ln \frac{\overline{Y_{t-1}}}{\overline{N_{t-1}}} \right) + \varepsilon_t$$

where $\varepsilon_t \sim N(0,\sigma^2)$. The deviation of the growth rate of output per capita from its unconditional mean of g follows an autoregressive process driven by short run deviations of explanatory variables $X_{k,t}$ from their unconditional means of X_k, and the short run deviations of the level of output per capita from its long run equilibrium value. The rate of convergence to long run equilibrium is determined by the speed of adjustment parameter $\beta<0$ of the cointegrating vector. Following Mankiw, Romer and Weil (1992), the equilibrium level of output per capita is expected to increase in the level of productivity,

the rate of labor force participation, in the rates of investment in private capital, public capital, and human capital and it is expected to decrease in the rate of growth of the labor force.

$$\frac{\overline{Y}_t}{\overline{N}_t} = f\left(\underset{+}{A_t}, \underset{+}{\frac{\overline{L}_t}{\overline{N}_t}}, \underset{+}{\frac{\overline{I_t^P}}{\overline{Y}_t}}, \underset{+}{\frac{\overline{I_t^P}}{\overline{Y}_t}}, \underset{+}{\frac{\overline{I_t^H}}{\overline{Y}_t}}, \underset{-}{n_t} \right)$$

A log-linear approximation of the equilibrium is reported below.

$$\ln\frac{\overline{Y}_t}{\overline{N}_t} = \ln A_0 + gt + \ln\frac{\overline{L}_t}{\overline{N}_t} + \sum_Z \frac{a^z}{1-a^P-a^G-a^H}\ln\frac{\overline{I_t^z}}{\overline{Y}_t} - \frac{a^P+a^G+a^H}{1-a^P-a^G-a^H}\ln(n_t+g+\delta)$$

Where the level of productivity A_t is represented as a function growing with time from a fixed initial level at t equal 0, the parameters a^z are the contribution of the factors of production to income of a production function with constant return to scale, n_t is the growth rate of the labor force and δ the amortization rate, supposed constant across the three types of capital.

Using the simplification that the cointegrating vector approximates the behavior of the economy in steady state, we can substitute in the long-run equilibrium conditions the steady state conditions of the accumulation functions of public and private physical and human capital. This approach allows avoiding assumptions about the initial stock of physical capital. All variables are stationary in first differences.

In addition to the cointegrating vector and the autoregressive process, the set of short run explanatory variables include the trade weighted average growth rate of output per capita across trading partners to capture the growth spillovers transmitted via international trade linkages and the real effective exchange rate.[82]

Table 3. Estimation Results for VEC Model of Per-Capita Output Growth

Coefficients of short run dynamics		
Lagged output per capita	0.02229	
Foreign output per capita	0.00001	
Real effective exchange rate	0.00018	
Long run disequilibrium	-0.33640	*
Coefficients of the cointegrating vector		
Productivity growth rate	0.00365	
Private investment	0.24253	**
Public investment	-0.06547	**
Human capital	0.05846	
Labor Force participation	3.37659	**
Labor force growth rate	-0.96026	**
Diagnostics:		
Observations	27	
R Squared	0.56000	

Note: Statistical significance at the 1 percent and 5 percent levels is indicated by **
and *, respectively.
g+d are restricted to 0.05, VEC is estimated with 1 lag

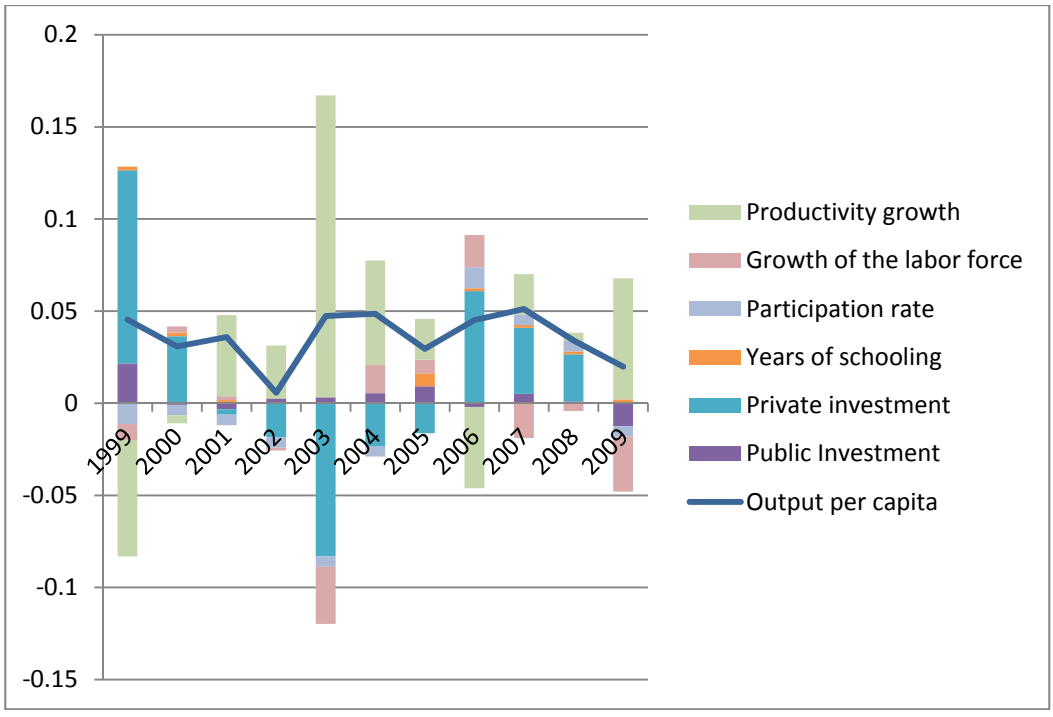
[82] Real interest rate data are not available for most of the sample period considered, from 1980 to 2009.

Most variables of the long-run equilibrium per capita growth rate have the expected signs and most are significant (Table 3). Public investment contribution to growth has a significant and negative coefficient in the cointegrating vector. The coefficient of the proxy for human capital (years of schooling) has the expected sign, but it is not significant. The factors of production contributing the most to per capita growth are private investment and an increase in the participation rate to the labor market (i.e. increase of employees as a percentage of the population of working age). The long run disequilibrium coefficient is of the expected sign and significant, implying that a positive deviation of 1 percentage point of the equilibrium level to the per capita output level in year t-1 translates, everything else equal, into a 0.3 percent per capita GDP growth in year t.

These results have to be interpreted with caution, because the analysis covers a sample of only 27 years and the cointegration tests fail to indicate that there is only one cointegrating vector.

A structural decomposition of growth in living standards in Tunisia in the past 29 years, from 1981 to 2009, into contributions from long run equilibrium determinants reveals the effect of private investment. Real per capita growth averaged 2.4 percent. Private investment contributed 1.5 percent, while public investment 0.3 percent, on average over the period. The participation rate of the labor force had a negative small contribution of 0.3 percent, due to a slight decline over the period of the employees with respect to the total working-age population. Productivity contributed to about 1 percentage point of growth, on average. Similar results are obtained over a sample of 10 years, from 1999 to 2009 (Figure 11).

Figure 11. Contributions to output per capita growth by structural determinant



Therefore, the analysis of the investment growth nexus concludes that long-term equilibrium output per capita mainly increases thanks to private investment and the increase in the labor force. This analysis highlights that the success of any public investment program is likely to have a positive effect on long term growth only if it will crowd in new private investment, through, for example improvement in the business climate or access to credit, and it will allow an increase of employment.

Appendix II. Debt Financed Investment

This analysis considers the effect of debt financing on total public and private investment, to estimate possible threshold effects. This analysis is complementary to the investment-growth nexus as it defines quantitative indicative limits for the economy of financing investment, which will help achieve long-term growth.

The analysis considers typical regressors of investment, which are found in the literature[83]. This includes real GDP growth, openness, primary enrollment, domestic credit to the economy, inflation, as a measure of volatility. These variables are used as control variables to measure the impact of the variables of interest, the stock of debt and debt service. All variables are either scaled by nominal GDP or growth rates.

Given constraints on data availability, different periods are considered in the analysis, which allows also to estimate the robustness of the results. The analysis considers three overlapping period: from 1970-2010, from 1970 to 2007 and from 1986 to 2010. The first period includes only GDF variables, and debt variables are limited to public and publicly guaranteed external debt only. The second period includes GDF variables but uses data on external, domestic and total public debt of the central government from the Christensen-Abbas database. The third and shortest period, starting in 1986 includes debt and debt service variables provided by the Tunisian Government for the external and the domestic debt of the central government.

All variables, except the investment as percentage of GDP and the GDP growth rate are non-stationary I(1) processes in all three sample periods.

The regressions used OLS and GLS, to correct for hetheroskedastic residuals. All regressions include auto-regressive processes. All residuals have been found normally distributed and uncorrelated. OLS/GLS estimates cannot resolve endogeneity issues, for which IV estimates have been conducted, with instruments the lagged values of GDP growth, all other regressors and the endogenous variable to account for the autoregressive term.

To fully account for non-stationarity and possible endogeneity of the regressors, a cointegration analysis through a VECM has been performed using data of the longest two samples.

Table 4 reports the point estimates and the significance levels for the OLS, and GLS and IV estimates. Results are not robust across samples and specifications. No significant results on the variables of interest are obtained for the regressions on the shortest samples (1986-2010), which uses data provided by the authorities. On the samples using data from 1970 to 2007, there is evidence of debt overhang, but not of crowding out. Data limitation prevents the analysis to concentrate on debt service on domestic debt for the longest sample periods, when only external debt service data are available. According to the results of GLS regressions, investments are positively associated with public debt only if the indebtedness ratio does not exceed 45-50 percent of GDP (see regressions 3 and 4). This is simply demonstrated by taking the first derivative of the investment ratio for the indebtedness ratio[84]. The sign of estimated coefficients of equation (5) is consistent with the debt overhang effect for domestic debt only, but estimates are not significant. GLS applied to the longest sample includes only external debt and debt service. The overhang effect for external debt is not confirmed, but external debt has a negative and significant coefficient, which implies that investments are reduced as a result of external debt financing.

[83] See for a Survey Presbitero (2008).

[84] For equation (3), the fist derivative is equal to 0.0199-2*0.0002*TD_GDP. The derivatives remain positive for a debt level lower than 50 percent of GDP. The derivative for regression (4) yields a debt ratio lower than 45 percent of GDP.

The analysis for the sample 1970-2007 implies that, everything else equal, debt financing reduces investments if public debt of the central government exceeds a range between 45-50 percent of GDP. No liquidity constraints will justify displacement of total investment due to an increase of debt service payments.

Table 4: Effects of Debt and Debt service on Investment

Dependent variable	(1)	(2)	(3)	(4)	(5)	(6)
Estimator	OLS	GLS1/	GLS1/	GLS1/	GLS1/	GLS1/
Sample period	1989-2009	1989-2009	1977-2007	1972-2007	1972-2007	1973-2009
DLGDP	0.13029	0.179187	-0.10983	0.034236	0.015115	-0.04017
OPEN	0.018354	0.008713	-0.14183 *			
INF	0.015243	-0.00651	0.235648	0.16868	0.126482	0.118642
ENR_P	-0.00044	0.000229	-0.00214 *	-0.00099	-0.00125	-0.00176
NDOMCRED	0.054688	0.072995	0.212737 *	0.231069 *	0.103248	-0.02919
TD_GDP	1.247723	..	0.019993 *	0.00658 *		
TD_GDP^2	-1.09493	..	-0.0002 **	-7.23E-05 *		
DD_GDP		-0.69733			0.00349	
DD_GDP^2		2.219618			-0.00014	
TDS_GDP	0.175776	..				
DDS_GDP		0.157337				
ED_GDP						-0.3134 *
ED_GDP^2						0.213197
EDS_GDP			0.3982	-0.10352	...	0.753734 *
C	-0.133	0.200188	-0.03234	0.097783	0.311495 *	0.501272 **
inv-gdp (t-1)	1.286296 **	1.251506 **	0.280513	0.873874 **	0.836476 **	1.289687 **
inv-gdp (t-2)	-0.75499 **	-0.66057 **				-0.66812 **
Observations	21	21	31	36	36	37
R2	0.78821	0.757291	0.868617	0.821259	0.771539	0.848559
Adj. R2	0.57642	0.514582	0.812311	0.768298	0.714424	0.798078
F-test (*p-value*)	0.024893	0.043469	0.000000	0.000000	0.000000	0.000000

1/ White heteroskedasticity-consistent standard errors & covariance

Table 5. Estimation Results for VEC Model of Debt on Investment

	(1)	(2)
Coefficients of short run dynamics		
Inflation	0.298102	-0.571272
Primary enrollment	-0.006099 *	-0.011445
Net domestic credit	0.202815	-0.36823
Long run disequilibrium	-0.42776 **	-0.697436 *
Coefficients of the cointegrating vector		
GDP	0.800773 **	0.661918 **
Total public debt	0.077122 **	0.115458 **
Total public debt^2	-0.000786 **	-0.001055 **
Diagnostics:		
Observations	36	33
R Squared	0.58649	0.873672

(1) Schwarz information criterion selects 1 lag in VECM.
(2) Akaike information criterion selects 4 lags in VECM.

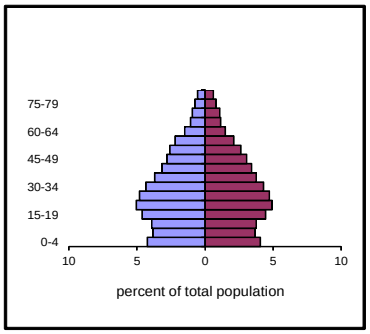
The single OLS/GLS regressions do not allow to account for the endogenity of investment and GDP. Debt overhang effects are associated with lower GDP growth due to disincentive to invest, and higher investments are associated with higher GDP growth. The cointegration analysis addresses these two issues, as both investment and growth are treated as endogenous variables. The analysis also allows to differentiate between long run and short run dynamics of growth, investment and debt.

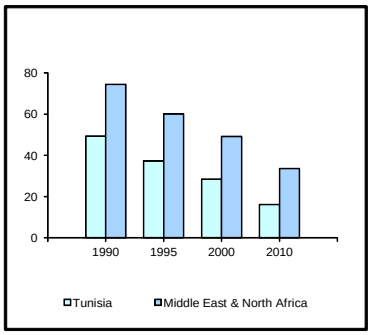
VECM have been estimated for the two longest periods (from 1970 to 2007 and from 1970 to 2010). Both the trace and λ statistics identify one cointegrating vector at the 1 percent significant levels and the λ statistic one vector at the 5 percent confidence. The result of the long run equilibrium relationship confirms that investment is positively related to debt financing up to a level of 50-55 percent of GDP, according to the lags of the VECM. The effect of debt on total investment turns then negative after that threshold. Data do not signal any significant effect of debt on growth (like the debt overhang hypothesis will imply).

ANNEX 10: COUNTRY AT A GLANCE (includes country map)

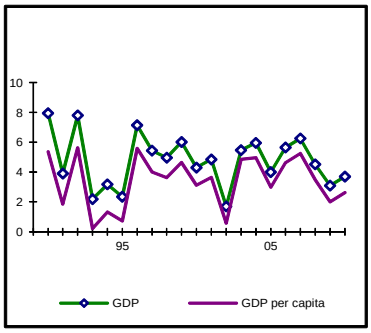
4/5/12

Key Development Indicators	Tunisia	M. East & North Africa	Upper middle income
(2010)			
Population, mid-year (millions)	10.5	331	2,452
Surface area (thousand sq. km)	164	8,775	59,328
Population growth (%)	1.0	1.7	0.7
Urban population (% of total population)	67	58	57
GNI (Atlas method, US$ billions)	43.9	1,283	14,429
GNI per capita (Atlas method, US$)	4,160	3,874	5,884
GNI per capita (PPP, international $)	9,060	*8,068*	9,970
GDP growth (%)	3.7	4.3	7.8
GDP per capita growth (%)	2.6	2.5	7.1
(most recent estimate, 2004–2010)			
Poverty headcount ratio at $1.25 a day (PPP, %)	<2	3	..
Poverty headcount ratio at $2.00 a day (PPP, %)	8	14	..
Life expectancy at birth (years)	75	72	73
Infant mortality (per 1,000 live births)	14	27	17
Child malnutrition (% of children under 5)	3	8	3
Adult literacy, male (% of ages 15 and older)	86	82	96
Adult literacy, female (% of ages 15 and older)	71	66	91
Gross primary enrollment, male (% of age group)	111	106	111
Gross primary enrollment, female (% of age group)	107	98	111
Access to an improved water source (% of population)	94	89	93
Access to improved sanitation facilities (% of population)	85	88	73





Net Aid Flows	1980	1990	2000	2010
(US$ millions)				
Net ODA and official aid	240	393	222	551
Top 3 donors (in 2010):				
Spain	0	1	2	158
France	79	76	93	127
European Union Institutions	1	25	71	92
Aid (% of GNI)	2.8	3.3	1.1	1.3
Aid per capita (US$)	38	48	23	52



Long-Term Economic Trends	1980	1990	2000	2010	1980–90	1990–2000	2000–10
					(average annual growth %)		
Consumer prices (annual % change)	..	6.5	3.0	4.4			
GDP implicit deflator (annual % change)	12.8	4.5	3.7	4.0			
Exchange rate (annual average, local per US$)	0.4	0.9	1.4	1.4			
Terms of trade index (2000 = 100)	..	64	100	100			
Population, mid-year (millions)	6.4	8.2	9.6	10.5	2.4	1.6	1.0
GDP (US$ millions)	8,743	12,291	21,473	44,291	3.3	4.7	4.7
		(% of GDP)					
Agriculture	16.3	17.7	11.3	8.0	2.8	2.6	2.5
Industry	35.9	33.6	30.4	32.3	3.1	4.4	3.0
Manufacturing	13.6	19.1	18.5	18.0	3.7	5.7	2.8
Services	47.7	48.7	58.3	59.7	3.7	5.5	*6.6*
Household final consumption expenditure	61.5	63.6	60.6	62.7	2.9	4.2	4.7
General gov't final consumption expenditure	14.5	16.4	16.7	16.3	3.8	4.5	5.1
Gross capital formation	29.4	27.1	26.1	26.4	-1.8	3.1	3.9
Exports of goods and services	40.2	43.6	39.5	48.7	5.6	5.3	3.4
Imports of goods and services	45.6	50.6	42.9	54.0	1.7	3.7	3.0
Gross savings	25.1	21.7	22.1	22.5			

Note: Figures in italics are for years other than those specified. .. indicates data are not available.

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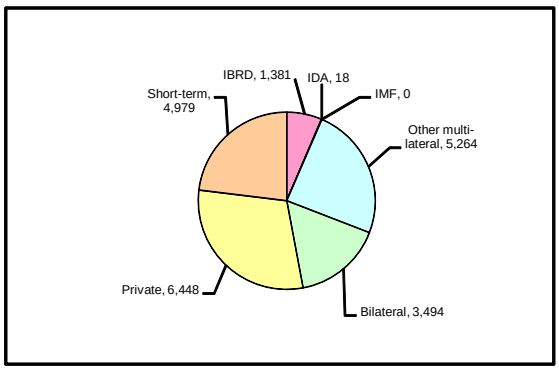
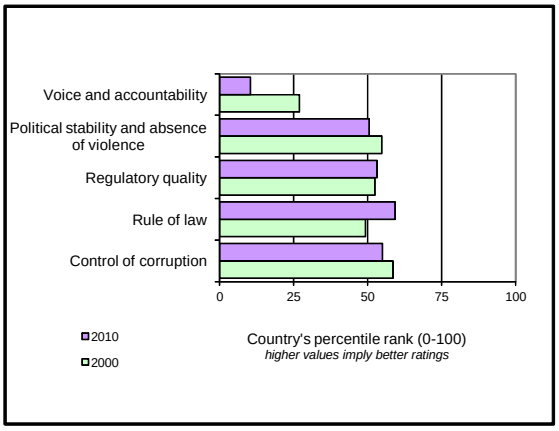
Balance of Payments and Trade	2000	2010
(US$ millions)		
Total merchandise exports (fob)	5,840	16,431
Total merchandise imports (cif)	8,556	22,228
Net trade in goods and services	-705	-2,115
Current account balance	-821	-2,118
as a % of GDP	-3.8	-4.8
Workers' remittances and compensation of employees (receipts)	796	1,970
Reserves, including gold	1,821	11,431

Central Government Finance		
(% of GDP)		
Current revenue (including grants)	21.8	22.9
Tax revenue	*19.6*	20.1
Current expenditure	18.0	17.8
Overall surplus/deficit	-3.4	-1.2
Highest marginal tax rate (%)		
Individual	..	..
Corporate	..	*30*

External Debt and Resource Flows		
(US$ millions)		
Total debt outstanding and disbursed	11,307	21,584
Total debt service	1,906	2,349
Debt relief (HIPC, MDRI)	–	–
Total debt (% of GDP)	52.7	48.7
Total debt service (% of exports)	20.1	7.5
Foreign direct investment (net inflows)	752	1,401
Portfolio equity (net inflows)	-18	-26



Private Sector Development	2000	2011
Time required to start a business (days)	–	11
Cost to start a business (% of GNI per capita)	–	4.2
Time required to register property (days)	–	39
Ranked as a major constraint to business (% of managers surveyed who agreed)	**2000**	**2010**
n.a.	..	..
n.a.	..	..
Stock market capitalization (% of GDP)	13.2	24.1
Bank capital to asset ratio (%)	*7.5*	..



Technology and Infrastructure	2000	2010
Paved roads (% of total)	68.4	*75.2*
Fixed line and mobile phone subscribers (per 100 people)	11	118
High technology exports (% of manufactured exports)	3.4	4.9

Environment		
Agricultural land (% of land area)	61	*63*
Forest area (% of land area)	5.4	6.5
Terrestrial protected areas (% of land area)	1.3	1.3
Freshwater resources per capita (cu. meters)	*429*	*402*
Freshwater withdrawal (% of internal resources)	*67.6*	*61.7*
CO2 emissions per capita (mt)	2.1	*2.4*
GDP per unit of energy use (2005 PPP $ per kg of oil equivalent)	8.0	*9.5*
Energy use per capita (kg of oil equivalent)	764	*881*

World Bank Group portfolio	2000	2010
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	1,211	1,381
Disbursements	136	234
Principal repayments	150	157
Interest payments	79	42
IDA		
Total debt outstanding and disbursed	39	18
Disbursements	0	0
Total debt service	2	2
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	11	342
of which IFC own account	11	230
Disbursements for IFC own account	1	89
Portfolio sales, prepayments and repayments for IFC own account	1	12
MIGA		
Gross exposure	–	–
New guarantees	–	–

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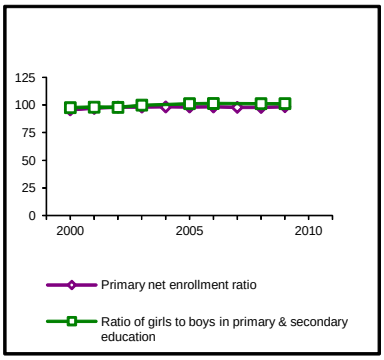
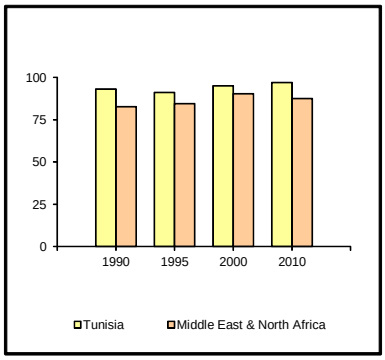
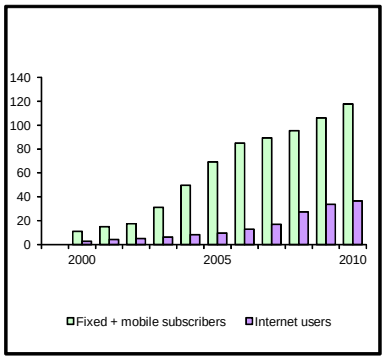
With selected targets to achieve between 1990 and 2015
(estimate closest to date shown, +/- 2 years)

	Tunisia			
Goal 1: halve the rates for extreme poverty and malnutrition	**1990**	**1995**	**2000**	**2010**
Poverty headcount ratio at $1.25 a day (PPP, % of population)	5.9	6.5	2.6	*<2*
Poverty headcount ratio at national poverty line (% of population)	6.7	6.2	4.2	*3.8*
Share of income or consumption to the poorest quintile (%)	5.9	5.7	6.0	*5.9*
Prevalence of malnutrition (% of children under 5)	*8.5*	8.1	3.5	*3.3*
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	93	97	96	*98*
Primary completion rate (% of relevant age group)	80	92	88	*91*
Secondary school enrollment (gross, %)	44	58	76	*90*
Youth literacy rate (% of people ages 15-24)	..	..	..	*97*
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	85	92	98	*101*
Women employed in the nonagricultural sector (% of nonagricultural employment)	..	*23*	24	..
Proportion of seats held by women in national parliament (%)	4	*7*	12	28
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1,000)	49	37	28	16
Infant mortality rate (per 1,000 live births)	39	31	24	14
Measles immunization (proportion of one-year olds immunized, %)	93	91	95	97
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	130	110	83	*60*
Births attended by skilled health staff (% of total)	*69*	81	90	*95*
Contraceptive prevalence (% of women ages 15-49)	*50*	60	66	*60*
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15-49)	0.1	0.1	0.1	*0.1*
Incidence of tuberculosis (per 100,000 people)	29	29	24	25
Tuberculosis case detection rate (%, all forms)	87	92	90	91
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	81	86	90	*94*
Access to improved sanitation facilities (% of population)	74	78	81	*85*
Forest area (% of total land area)	4.1	..	5.4	6.5
Terrestrial protected areas (% of land area)	1.3	1.3	1.3	1.3
CO2 emissions (metric tons per capita)	1.6	1.8	2.1	*2.4*
GDP per unit of energy use (constant 2005 PPP $ per kg of oil equivalent)	7.4	7.6	8.0	*9.5*
Goal 8: develop a global partnership for development				
Telephone mainlines (per 100 people)	3.7	5.8	10.0	12.2
Mobile phone subscribers (per 100 people)	0.0	0.0	1.2	105.4
Internet users (per 100 people)	0.0	0.0	2.7	36.6
Computer users (per 100 people)	..	..	..	..







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