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Operation Name	Business Environment and Entrepreneurship (BEE) DPF
Region	Middle East and North Africa
Country	Tunisia
Sector	General public administration sector (20%); Central government administration (10%); Trade and Competitiveness (30%); Banking and Finance (30%); Other (10%)
Operation ID	P158111
Lending Instrument	Development Policy Financing
Borrower(s)	Government of Tunisia
Implementing Agency	Ministry of Development, Investment and International Cooperation
Date PID Prepared	April 24, 2017
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Corporate Review Decision	*TBD*

I. Key development issues and rationale for Bank involvement

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

This weak economic performance poses a risk to past poverty reduction gains, to the promotion of greater inclusion—especially for the middle class—and to Tunisia's young democracy. While poverty incidence was halved between 2000 and 2010 (from 32.5 to 15.5

percent), considerable disparities exist among regions and age groups, and household vulnerability remains considerable especially in the face of weak post-revolution economic performance. These disparities have persisted or widened. Inequality between regions has risen with poverty increasingly concentrated in a few regions of the country. Just as importantly, the data suggests that many households (including those from the middle class) remain slightly above the poverty threshold, making them vulnerable to exogenous shocks such as the loss of employment or hikes in the prices of essential goods. Growth has been inadequate to generate sufficient jobs to absorb new entrants into the labor market. As a consequence, the unemployment rate has remained high (15.4 percent in 2015), especially among women (22.6 percent), young university graduates (31 percent), and the population of the interior regions off the coast (26.2 percent in the South-East, 23.1 percent in the South-West, and 19 percent in the Center-West compared to 10.7 percent and 9.9 percent in the North-East and Center-East, respectively). Demographic trends suggest that unless the pace of growth accelerates substantially, unemployment will worsen over the next decade. Several large protests in early 2016 was a reminder that tackling unemployment, especially of youth and in the interior regions where the 2011 revolution started, is critical for social stability.

The Government response to the employment and social challenges by raising public sector hiring and salaries has helped maintain social peace. But this has also contributed to significant weakening of Tunisia's fiscal situation. The number of civil servants (central Government) has increased by about 40 percent since 2010, reaching 650,175 in 2016 (16 percent of the country's active population). In addition, there are about 180,000 workers in public enterprises and 20,870 workers in local Government. In late 2015, the Government agreed to a general wage increase schedule with the workers' union. As a consequence, the public wage bill has increased from 10.7 percent in 2010 to 14.5 percent of GDP in 2016 and represents over 60 percent of tax revenues. This unfortunate trend has contributed to weakening of Tunisia's macroeconomic framework. The twin deficit in 2015 was high, at 5.7 percent and 8.9 percent of GDP for the fiscal and current account, respectively. Public debt has risen markedly in the post-revolution period (from 40 percent of GDP in 2010 to 63 percent by end-2016), even if it remains reasonable by international standards[1].

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

Accelerating job creation and promoting inclusion and shared prosperity in Tunisia also entails supporting entrepreneurship and deepening access to finance. The existing private sector has been unable to create enough jobs, a situation that has been accentuated in the post-revolution period by the deterioration of the economic situation. The privileged segment of the established private sector and workers' unions have also opposed reforms to improve competition, reduce rents and capture, and open up the economy at the expense of faster job

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

creation. As a result and compounding the challenge of creating good jobs , very few new firms enter the market each year, the overwhelming majority enter as small firms and remain small or exit within three to five years (see Tunisia Development Policy Review 2014 and Jobs or Privileges regional report 2015[2]). Resolving these challenges through appropriate financial and non-financial support to the promotion of entrepreneurship will contribute to improving private-sector-led growth and job creation. Improving access to finance to SMEs, expanding access to housing finance, reducing financial transaction costs through more inclusive payment systems, information sharing via credit bureaus will promote private sector growth and job creation. In addition the WBG is complementing these support to policy reforms with concrete actions and on the ground to stimulate entrepreneurship and link poor and vulnerable population to economic opportunities, especially for women and in Tunisia's lagging regions (e.g. recent hackathon events for women economic empowerment, see box 3, value chain development activities in four investment projects and economic inclusion project targeting the poor and vulnerable women and youth in lagging areas).

In preparing this operation, the Bank has and will continue to draw lessons from the previous DPFs financed during the 2011-2015 transition period. During the transition period, reform progress was uneven, and in some cases, below expectations. The delays in economic reforms were partly caused by the country's nascent and generally fragile political environment in which emphasis was placed on advancing the political transition through the writing of the Constitution, revamping the electoral laws, reorganizing the Government and the judiciary and laws related to fighting terrorism. In addition, most reforms were adopted in a "policy vacuum" during a period of short political cycles. In this sense, the overall level of ambition, political feasibility and institutional capacity were not systematically factored into program design. Moreover, the revolution has introduced into the public arena new voices, the principle of stakeholder consultations and consensus building around reforms. At the same time, some longstanding reforms that seek to open the economy and eliminate rents and elite capture have faced strong opposition from vested interests leading to reform dilution and delays. Finding ways to support pro-reform coalitions within the administration and among non-Governmental stakeholders is key for implementing timely reforms as well as supporting the new social contract. In some cases, reforms have been hampered by limited communication about reform objectives and lack of coordination among potential reform winners.

The country context has generally improved since the previous DPF series and the new Government has renewed the reform momentum and efforts to improve investor and citizen confidence. The short political cycles and the policy vacuum are now replaced by the Government with a vision and an already developed "*note orientation*" as well as a Five-Year Development Plan approved on April 12, 2017 that reflects a comprehensive reform agenda that anchors the reforms supported by this DPF. Since early 2015, progress has been made, especially on statutory reforms that are critical for private investment (e.g., competition law, the bankruptcy law, the banking law, the PPP law and more recently the investment law, etc.). The Government also successfully organized an investor conference in late November 2016 that provided a platform to present progress made since the Presidential elections, to call for renewed support of the global community to Tunisia's young democracy, to highlight improvements in the security

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

situation and the potential of the country to attract investment (in terms of location, human and physical capital) and ongoing and future efforts to strengthen the business environment. Moving forward, more attention is needed to accelerate the reforms and their implementation. This includes ensuring statutory reforms lead to measurable impacts on the investment climate, both economy-wide and in key sectors.

The design of the DPF is also better tailored to the country context and addresses explicitly political and institutional risks. In particular, the political economy filter, piloted for this operation, is being systematically applied in the reform areas covered by the DPF. The objective of this filter is to help the Bank understand better the risks and conditions for the success of adoption and implementation of reforms and identify potential mitigation measures. The timing of the DPF will also be key to its success: given political risks and the contentious nature of reforms, the Government counterparts have been conducting the necessary consultations, engaging in a robust dialogue based on trust, building stronger coalitions for reform, and ensuring that capacity is built to implement the changes.

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

Reforms supported by the proposed DPF are also aligned with the first and fourth pillars of the Tunisia Country Partnership Framework (CPF) and the MENA regional strategy. The proposed DPF aims at supporting Tunisia tackle the challenges of promoting stronger and more inclusive private-sector led growth, leading to faster job creation and economic recovery over the medium term. The proposed DPF focuses on two policy areas: (1) improving the business environment; and (2) supporting entrepreneurship and deepening access to finance. There is a special emphasis on completing and implementing the reform agenda that was started during the transition period, and to engage in key new areas that are essential for achieving the economic and social objectives of the new Government such as the need to improve the support for entrepreneurship. This DPF is consistent with the WBG MENA Strategy's and Tunisia CPF's objectives of tackling the underlying causes and remedying the consequences of social tension. Specifically, the proposed operation would contribute to *Renewing the social contract* pillar, as the supported policy measures will strengthen the business environment and competition framework, improve the financing for young firms and entrepreneurs, and promote greater access to for young MSMEs and entrepreneurs.

Following the 2014 presidential and parliamentary elections, the Government has developed: (1) a concept note for the 2016-2020 development plan, the "Note d'Orientation Stratégique", followed by (2) a "National Program of Major Reforms", and (3) the five-year development plan which was approved by Parliament on April 12, 2017. The three documents outline Tunisia's development vision and strategic orientation for the next five years, clearly stating that Tunisia will maintain its strong partnerships with the international community, rely on the private sector to lead economic growth and job creation, and at the same time promote a vibrant civil society.

The three aforementioned documents present a new development model that aims at achieving "economic efficiency based on innovation and partnership, social inclusion and sustainable development." Achieving these objectives requires improvement of the business environment and progress in the implementation of major reforms, including modernization of the administration, revision of the procurement system, promulgation of a new investment code, improved equity of the tax regime, and implementation of policies to boost public-private partnerships. The five-year plan emphasizes three axes of economic reform:

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

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

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

The reform momentum has generally accelerated, and the focus has shifted to implementation. Since fall 2015, the Parliament has approved several legislations, including the law on access to information, the competition law, the PPP law, the law governing the Central Bank, the law on collective procedures, the banking law, and more recently the investment code. The challenge now is implementation of such reforms for the benefit of the population.

Civil society continues to play an important role in the post-transition period. In early June, President Béji Caïd Essebsi asked for the formation of a national unity Government that would unite politicians, employers and the largest workers' union. The main aim of the national unity Government which includes the main trade union ("Union Générale Tunisienne du Travail", UGTT) and the main business confederation ("Union Tunisienne de l'Industrie, du Commerce et de l'Artisanat", UTICA) is to solve the economic and social crises currently facing Tunisia. UGTT and UTICA were part of the quartet that secured Tunisia's democratic transition, winning them a Nobel Prize. They also played an important role in the conception of a 'new Social Contract' signed in January 2013, a consensual action plan to pave the way for key reforms in the social sectors (social security reform, subsidy reform, vocational training reform, etc.). In July 2016, these stakeholders, together with the main political parties, signed the **"Carthage Agreement"** which lays out the roadmap that the national unity Government should follow to solve Tunisia's economic and social crises. The roadmap is aligned with the Five-Year Development Plan, putting strong emphasis on the fight against terrorism, fiscal sustainability, regional development, the need to accelerate growth and employment and improve governance, as well as the performance of the civil service and Government institutions. The new Government is characterized by the younger leadership and greater participation of civil society as accountable decision makers to ensure endorsement of the reforms under preparation.

II. Proposed Objective(s)

The proposed Business Environment and Entrepreneurship Development Policy Financing aims to support the Government of Tunisia (GoT) reform efforts. The proposed DPF (BEE DPF), in the amount of US$500 million equivalent**,** is a standalone single-tranche operations to support key areas of reform in the Government's Five-Year Development Plan for 2016-2020 whose implementation is essential for achieving the economic and social objectives of the new Government. The DPF would help Tunisia achieve stronger and more inclusive growth, and job creation led by the private sector, particularly by stimulating entrepreneurship.

The design of the DPF is also better tailored to the country context and addresses explicitly political and institutional risks. In particular, the political economy filter, piloted for this operation, is being systematically applied in the reform areas covered by the DPF series. The objective of the political economy filter is to help the Bank understand better the risks and conditions for the success of adoption and implementation of reforms and identify potential mitigation measures. The timing of the DPF series will also be key to its success: given political risks and the contentious nature of reforms, the Government counterparts have been conducting the necessary consultations, engaging in a robust dialogue based on trust, building stronger coalitions for reform, and ensuring that capacity is built to implement the changes.

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

Reforms supported by the proposed DPF are also aligned with the first and fourth pillars of the Tunisia Country Partnership Framework (CPF) and the MENA regional strategy. The proposed DPF aims at assisting Tunisia to tackle the challenges of promoting stronger and more inclusive growth, leading to job creation and economic recovery over the medium term. The proposed DPF focuses on three key policy areas: (1) enhancing fiscal efficiency by improving the budgetary framework, reforming the public investment management and debt management frameworks, and supporting their implementation; (2) improving the business environment, promoting competition and the development of backbone services; and (3) supporting entrepreneurship and deepening access to finance. There is a special emphasis on completing and implementing the reform agenda that was started during the transition period, and which is essential for achieving the economic and social objectives of the new Government. This DPF is consistent with the WBG MNA Strategy's and Tunisia CPF's objectives of tackling the underlying causes and remedying the consequences of social tension. Specifically, the proposed operation would contribute to *Renewing the social contract* pillar, as the supported policy measures will strengthen the business environment and competition framework, improve financial and business services to entrepreneurs, and promote greater access to finance.

III. Preliminary Description

The proposed DPF is a standalone single-tranche operation aimed to support private sector development, entrepreneurship and access to finance in Tunisia in its post-transition period. The proposed operation is designed to support key areas of reform in the Government's Five-Year Plan for 2016-2020 and the Government's efforts to complete the economic reforms initiated during the political transition, whose implementation is essential for achieving the economic objectives laid out in the Five-Year Development Plan. The operation is strongly linked to Axes 2 and 3 of the major economic reforms under the five-year plan, putting the private sector at the heart of growth and job creation agenda and creating a level playing field for competition. The operation also contributes to the goals of Axis 1 in terms of improving governance, transparency, and supporting digitization to improve administrative and service delivery efficiency.

The DPF series is organized under two key pillars: (1) improving the business environment; and (2) supporting entrepreneurship and deepening access to finance. The reforms are the focus of the intensive policy dialogue with the Bank, and have benefitted from continuous technical support to ensure that they adhere to quality standards and produce expected development outcomes in terms of economic and social opportunities.

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

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The policies supported by this operation are not expected to have negative poverty and social impacts; positive impacts are expected thanks to improved growth, investment and job creation. The investment climate and competition measures are expected to yield direct benefits in terms of consumer welfare, improved competitiveness of Tunisian companies, and increased attractiveness for investors. The effect of greater competition on net job creation could be negative in the very short-term as less competitive firms shed jobs but additional jobs created by new entrants and more productive firms could dominate this effect especially in the medium-term. Improved allocation (equity) and efficiency of public investment will have positive impact on the reduction of poverty and inequality.

Greater availability of financing for entrepreneurship will improve job creation through the creation of new firms and the survival and growth of existing young firms. The establishment of private credit bureau will enhance lenders' risk assessment and should contribute to lowering possible adverse effects related to the risk of household and individual over-indebtedness.

Environment Aspects

Over the last years, Tunisia has confirmed a consistent, high level, and long-term commitment for environment protection. The Tunisian Constitution explicitly addresses the need to safeguard a healthy environment and to tackle climate change. The Government's *Note d'Orientation Stratégique* which outlines Tunisia's development vision for the next five years consists of five pillars, with the fifth one dedicated to promoting green growth for sustainable development. The 2016-2020 Five-Year Development Plan tackles several critical challenges, including the implementation of key aspects of sustainable development, to provide a balanced territorial development and integrate all regions, while respecting the environment. The implementation of the action plan depends on a rational use of natural resources, better environmental protection, and greater control on energy consumption.

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

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

V. Tentative financing

Source:		($m.) 500
Borrower/Recipient: Republic of Tunisia		
IBRD		
Others (specifiy)		
	Total	500

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