PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

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Operation Name	Tunisia: Third Governance, Opportunities, and Jobs DPL
Region	MIDDLE EAST AND NORTH AFRICA
Country	Tunisia
Sector	Central government administration (30%); General public administration sector (20%); Other social services (20%); Banking (20%); Telecommunications (10%)
Operation ID	P150950
Lending Instrument	Development Policy Lending
Borrower(s)	GOVERNMENT OF TUNISIA
Implementing Agency	Ministry of Economy and Finance
Date PID Prepared	July 4, 2015
Estimated Date of Appraisal	May 2015
Estimated Date of Board Approval	September 2015
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Country and Sector Background

Since the 2011 Revolution, while the successful completion of the general elections and the transition to the new constitutional order have been remarkably flawless, economic recovery is slow, and social and security tensions have mounted since the installation of the new government. The deterioration of the security culminated in two violent terrorist attacks on March 18 terrorist attack at the Bardo Museum in Tunis, and the second attack on the holiday resort in Sousse on June 26. The Parliamentary and Presidential elections had taken place in the last quarter of 2014, in full compliance with the transition roadmap that had been agreed to by political parties and civil society to resolve the political deadlock of 2013. The elections resulted in the secular party Nidaa Tounes winning 86 of the 217 seats in Parliament ahead of the moderate Islamist Ennahda party (69 seats). The two rounds of equally peaceful Presidential elections organized shortly after saw the leader of Nidaa Tounes, M. Beji Caid Essebsi win with 55 percent of the vote. A non-partisan Prime Minister, M. Habib Essid, was designated in early 2015 and formed a coalition Government, gathering representatives from Nidaa Tounes, Ennahda, as well as from the third and fifth largest parties in Parliament, securing hereby a relatively comfortable majority in the National Assembly, which is essential in view of the important legislative agenda related to the reform program. As it took office, the new Government has been confronted with social tensions, notably in the interior regions and in the South, and more importantly, the country has been hit by the two major terrorist attack directly targeting the tourism sector, and impacting the Tunisian economy at large.

On the economic front, Tunisia’s growth record has allowed the country to gradually climb the income ladder over the past three decades, but the country is facing typical hurdles related to the middle-income trap, compounded by specific challenges to further economic and social progress. Tunisia’s growth rates have been faltering in recent years as the country struggles to maintain its competitiveness, increase productivity and move the value chain, symptoms commonly referred to as the “middle-income” trap. In addition, Tunisia is facing specific and interrelated challenges characterizing its current socio-economic environment, among which (i) high level of youth unemployment (graduate and non-graduate); (ii) the volatile domestic security environment; (iii) the exposure to regional political instability; and (iv) the high dependency of trade and investment flows towards the Euro area. The SCD and other Bank work highlight the lack of contestable and competitive markets, notably in economic backbone sectors, the weight of regulation and administrative procedures, inadequate access to finance, and governance challenges as some key structural challenges for higher growth and better access to economic opportunities for citizens and businesses. The economic slowdown has been dramatically aggravated by the shock resulting from the terrorist attacks of 2015, with growth now estimated to reach 0.8 percent only, while earlier estimates had placed it at 2.6 percent. The tourism industry, representing about 8 percent of GDP and employing (directly and indirectly) 400,000 people (about 10 percent of the workforce) will be critically impacted. More generally, this security shock is also likely to affect investor confidence, and delay the prospects for recovery in private investment (which had been boosted somewhat after the successful political transition).As a result of the shock, Tunisia’s financing needs have changed and the authorities are envisaging measures to close their financing gap.

While the new government has taken immediate steps to address the security crisis and mitigate social tensions, it has also started laying the foundations for its medium-term development policy. More specifically, the authorities decided to elaborate their policy framework on two tracks: (i) devise a program of short-term measures to be implemented within a 100 days and addressing some of immediate concerns faced by the population (eroding purchasing power, disruptions in the education sector, security), and (ii) prepare a new five year plan (2016-2020) of reforms and investments, that would be presented in the last quarter of the year. The ambitious “100 days program”, to be implemented by end May 2015, comprises no less than 130 actions, that have all been initiated and some completed by now. The program includes a number of measures that are consistent with the commitments taken by the previous government with respect to reforms supported by the ongoing SBA of the IMF and the Development Policy Loan (DPL) series of the Bank, such as the restructuring of public banks.

II. Operation Objectives

In this context, the DPL series aims at assisting Tunisia tackle the short-term challenges, including by providing emergency support in the context of the current security crisis, while paving the way to stronger and more inclusive growth, leading to job creation over the medium-term.[1] The reforms are seen as instrumental to achieve the objectives that have motivated the revolution: opening up the economy so that it can deploy more and better economic opportunities for the Tunisian people, in particular the youth, while entrenching participation and voice as key ingredients of policy making. Building upon achievements realized under the GOJ-1 and GOJ-2 DPLs, the reform program underpinning the proposed operation, focuses on the four key policy areas of the series: (i) promoting private investment and establishing a more competitive environment; (ii) restructuring the financial sector; (iii) improving the quality and accountability of social sector services; and (iv) increasing transparency and accountability of public policies and finance.

[1] See World Bank (May 2014), *The Unfinished Revolution. Bringing Opportunity, Good Jobs And Greater Wealth To All Tunisians,* Report No. 86179-TN.

Building upon achievements realized under the first and second DPL in the series, the supported reform program underpinning the proposed GOJ-3 DPL, focuses on three of the series' four key policy areas: (i) promoting private investment and establishing a more competitive environment; (ii) restructuring the financial sector and (iii) increasing transparency and accountability of public policies and finances. Measures in the area of improving the quality and accountability of social sector services have been supported in the first two operations of the series.

- **Private sector investment**: Key reforms focus on the telecommunications sector to (i) simplify the regulatory environment for businesses; (ii) expand regulatory reforms in the telecommunication sector to increase access to and affordability of broadband and internet services;
- **Financial sector strengthening**: the reforms focus on (i) restructuring state-owned banks so as to improve their operations and solidify their capital base, with a view to improve the overall banking environment;
- **Governance**: fundamental reform of the access to information framework in line with the provision of the new constitution, as well as improved transparency in public finances, notably in relation of operations by state-owned enterprises.

III. Rationale for Bank Involvement

While providing immediate policy responses to security and social emergencies, the Government has also initiated the preparation of a five year socio-economic development program that would be articulated around three themes: security, inclusion and economic recovery. With respect to its macroeconomic stabilization objectives, the Government will pursue fiscal consolidation even if the short-term financing needs will remain high on account of the security shocks of 2015. Specifically, the Government has embarked upon an ambitious tax and customs reform, aiming at mobilizing additional revenues by closing loopholes and tackling corruption and informal trade through administrative and tariff reforms. On the expenditure side, the Government will continue to tackle the growth of the wage bill and pursue the phase-out of energy subsidies, improve the targeting of social protection programs and improve the implementation of public investment projects benefitting from the recently reformed public procurement legislation, as well as tighten the oversight over public enterprises. In terms of regional development, the Government remains fully committed to create an enabling local governance environment in the context of the upcoming municipal elections. In order to improve the fiscal environment in regions, the Government has, with the assistance of the Bank, revised its vertical transfers system towards more transparency and predictability. Regarding structural economic reforms, the new Government is proceeding with the reforms that had been initiated during the transition, aiming at improving governance, strengthening the business environment and fostering the competitiveness of the economy. In this context, the Government is focusing on key sector policies to promote growth, notably in the financial and telecommunications sectors, while fostering social inclusion through the modernization of social insurance and protection.

While the Tunisian economy has continued to recover from the 2011 recession, growth weakened in 2013 and 2014. The recovery in FDI inflows and tourism receipts has not accelerated despite the positive political developments as investors continue to wait for the end of the political cycle and the security shock will further delay the recovery in tourism and of the economy as a whole. Following a period of expansionary fiscal and monetary policy between 2011 and 2013, the authorities have gradually tightened their policy stance, thereby creating a satisfactory macroeconomic framework for the proposed operation, despite the temporary effects of the security shock on public finances in 2015. To support its macroeconomic policies, Tunisia will also relay on the Stand-By Arrangement (SBA) with the IMF for a total amount of US$1.7 billion, which will end in December 2015. The IMF has successfully concluded the first five reviews of the program between January 2014 and December 2014, and the successful completion of the fifth review is imminent.

In this context, the Bank Group remains fully committed to supporting the stabilization of the Tunisian economy and efforts to lay the foundations for sustainable and inclusive growth. The programmatic multi-sector DPL operations are a central component of the World Bank's support to Tunisia as outlined in the 2012 Interim Strategy Note (see Section 4.3).[2] The World Bank Group team responsible for this operation includes the International Finance Corporation (IFC). As was the case for the predecessor operations in the series, the proposed GOJ-3 DPL has been prepared in close consultation with the European Union (EU), the IMF, the African Development Bank (AfDB), as well as bilateral partners.

IV. Tentative financing

Source:		($m.)
Borrower		0
International Bank for Reconstruction and Development		500
	Total	500

V. Institutional and Implementation Arrangements

The responsibility for coordinating the implementation of the program in Government rests with the Ministry of Development and International Cooperation. The Government takes the lead in monitoring progress in implementation of this operation. Given the importance and the visibility of the program, the Prime Minister's office, the Ministry of Finance and the Central Bank are also closely involved in the monitoring of the program design and implementation.

Regular supervision is undertaken by the Bank to continue providing policy advice and technical assistance to the institutions involved in the implementation of the program of reform, notably thanks to its staff based in the field. The Bank will continue to maintain continuous dialogue with relevant government ministries and will conduct regular reviews in close collaboration with other partners. Supervision by the Bank (and associated donors) is organized with a broad and inclusive approach, including the implementation follow up and assessment of measures and results of the forms supported as part of previous operations.

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.

[2] 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.

VI. Risks and Risk Mitigation

The risks to this operation relate to:

(i) Risks related to potential uncertainty arising from political or security tensions: While the political situation has improved markedly in 2014 and early 2015 with the successful completion of the democratic transition, the terrorists attacks of March and June 2015, are a tragic testimony that the security situation remains very fragile, due both to domestic factors (remaining terrorist cells active in the country) and the external environment (most notably the influence from the instability in neighboring Libya). Similarly, social tensions have been recurrent for most of the first half of 2015, with an impact on the political climate and on the productive capacity of the country. The security risk will be mitigated by the measures taken in the aftermath of the most recent terrorist attack on a tourism resort in Sousse. On the social front, the recent adoption of a decree institutionalizing the social dialogue, is a welcome step towards establishing an orderly process to resolve labor disputes. More generally, the security challenge is likely to lead to a more cooperative stance among social partners, as had already been demonstrated during the political crisis of 2013.

(ii) Risks related to the uncertainty of the macroeconomic outlook: In addition to the impact of the security and social tensions, uncertainty about the economic outlook related to the slow recovery of the Eurozone and the conflict in Libya, all pose significant risks to the economic stabilization in Tunisia. Low growth and poor employment prospects could reinforce a sense of lack of economic opportunity. The negative shock on the tourism sector related to the terrorist attacks 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 could further aggravate the already relatively tight liquidity and weak asset quality of the banking sector. To mitigate these risks, the authorities are considering various initiatives to improve public investment execution in the context of the 2015 supplemental budget, notably in lagging regions and have scaled-up some social interventions (cash transfers to the most vulnerable households). The measures supported by this operation will reinforce the banking sector and reduce the risks of financial instability. A continuation of the satisfactory implementation of the SBA with the IMF will contribute to provide a positive signal about the sustainability of the macroeconomic and fiscal framework. The completion of ongoing economic reforms before the end of 2015 and the finalization of the five year economic development program that will chart out the economic policy and reform plan over the medium term, will be essential to consolidate macroeconomic stability and maintain debt at sustainable levels, contributing to restore confidence among domestic and international investors in selected sectors of the economy.

(iii) Risks related to the institutional capacity for reform deliver: The actual implementation of the reforms supported since 2011 has proven uneven and has suffered delays, partly as a result of implementation capacity shortages, but also on account of the negative impact of the political uncertainty on the administration's resolve to carry out some of the reforms in a timely fashion. The Bank's technical continuous assistance will help bridge the implementation capacity gaps, notably with respect to the financial sector reforms (bank restructuring) and sector reforms (telecommunications). Technical support from other partners will contribute to mitigate the risk (notably the IMF in the area of financial sector reforms or the EU with respect to competition policy). The new government possesses a more predictable policy horizon, even if marred by the uncertainties mentioned above. The five year plan under preparation will establish a clear reform implementation roadmap that will steer the priorities of the administration. Additional institutional adjustments to strengthen reform preparation,

implementation and monitoring (in the form of a “reform delivery unit”) are being undertaken at the level of the Prime Minister’s office with the support of the Bank.

(iv) *Risks related to stakeholder resistance*. Some key stakeholders will oppose the reforms, notably if they hold a dominant position on the markets or if they extract undue rents that are challenged by the reforms. The Bank’s analytical work, chief among which the *Development Policy Review*, highlights risks of capture and subsequent disconnect between reforms on paper and real change on the ground for citizens and firms. Many of the reforms supported by the GOJ DPL series aim at empowering citizens to obviate this risk, and the Bank is itself investing considerable effort in awareness-raising and consensus-building. To this end, it has engaged in a broad-based consultation and dissemination effort of the DPR’s findings and recommendations. The Bank is also supporting a public awareness project, using local media, so as to spur and feed the national debate on key social and economic issues faced by Tunisia.

VII. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The poverty reduction impact of the policies supported by the DPL, namely enhancing growth and jobs creation in the medium term, putting in place systems to improve the quality of service delivery, and strengthening governance and access to information are expected to have positive social and poverty impacts. The specific policies supported by this DPL are not expected to have negative distributional and social impacts.

Environment Aspects

The reforms supported in this DPL operation are not expected to have significant positive or negative effects on the environment, forest and other natural resources. The DPL supports policy actions that create the enabling environment to support job creation, employment and poverty reduction, and which by themselves do not have an environmental impact. It is expected, however, that regular private and public investment activities which may result from such policy actions could have impacts on the environment. Nevertheless it is not expected that there will be a 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.

VIII. Contact points

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