Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No. 124855-TN

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

FOR A PROPOSED LOAN

IN THE AMOUNT OF EURO 413.4 MILLION

(EQUIVALENT TO US$500 MILLION)

TO THE

REPUBLIC OF TUNISIA

FOR THE

INVESTMENT, COMPETITIVENESS AND INCLUSION
DEVELOPMENT POLICY FINANCING

May 25, 2018

Macroeconomics, Trade and Investment Global Practice
Finance, Competitiveness and Innovation Global Practice
Middle East and North Africa Region

REPUBLIC OF TUNISIA

GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of *April 30, 2018*)

US$1 = Euro 0.82668540

ABBREVIATIONS AND ACRONYMS

ACM	Microfinance Regulatory Authority, *Autorité de Contrôle de la Microfinance*
AFD	French Development Agency, "*Agence Francaise de Developpement"*
AfDB	African Development Bank
ALMP	Active Labor Market Program
AMG	Free Health Insurance *Assurance Maladie Gratuite*
AML	Anti-Money Laundering
ASA	Advisory Services and Analytics
BH	Housing Bank, *Banque de l'Habitat*
BTK	*Banque Tuniso-Koweitienne*
BIS	Basic Investment Statistics
CBT	Central Bank of Tunisia
CFT	Combating the Financing of Terrorism
CNAM	National Health Insurance Fund, *Caisse Nationale d'Assurance Maladie*
CPF	Country Partnership Framework
CNRPS	National Pension and Social Welfare Fund, *Caisse Nationale de Retraite et de Prévoyance Sociale*
CNSS	National Social Security Fund, *Caisse Nationale de Securite Sociale*
CSE	High Council for Exports, *Conseil Supérieur des Exportations*
CRES	Research Center for Social Studies, *Centre de Recherches et d'Etudes Sociales*
DFID	Department for International Development
DPF	Development Policy Financing
DPR	Development Policy Review
DLIs	Disbursement-Linked Indicators
DSA	Debt Sustainability Analysis
EBRD	European Bank of Reconstruction and Development
EIA	Environmental Impact Assessment
EFF	Extended Fund Facility
ENBC	National Household Consumption Survey, *Enquete National Budget Consommation*
ESMAP	Energy Sector Management Assistance Programme
EU	European Union
FGPME	SME Credit Guarantee Fund, *Fonds de Garantie des Petites et Moyennes Entreprises*
GDP	Gross Domestic Product
GHG	Green House Gas
GIZ	German Agency for International Cooperation
GNI	Gross National Income
GOJ	Governance Opportunities and Jobs
GRS	Grievance Redress Service
HAICOP	Tunisian Public Procurement Authority, *Haute Instance de la Commande Publique*
IACE	Arab Institute of Entrepreneurs, *Institut Arabe des Chefs d'Entreprises*
IBP	Integrated Bank of projects
IBRD	International Bank for Reconstruction and Development
ICI	Investment, Competitiveness and Inclusion
ICT	Information and Communication Technologies
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IFI	International Financial Institutions
ILO	International Labor Organization
IO	Input-output
IMF	International Monetary Fund
INS	National Institute of Statistics, *Institut National de la Statistique*
ISIE	Independent Higher Authority for Elections, *Instance Supérieure Indépendantes pour les Elections*
JICA	Japan International Cooperation Agency
KfW	*Kreditanstalt für Wiederaufbau*, German Development Bank

FATF	Financial Action Task Force
FCI	Finance Competitiveness and Innovation
LPG	Liquified Petroleum Gas
MCAs	Micro Credit Associations
MDB	Multilateral Development Banks
MDGs	Millennium Development Goals
MDIIC	Ministry of Development, Investment, and International Cooperation
MELA	Ministry of Environment and Local Affairs
MEMER	Ministry of Energy, Mines and Renewable Energy
MENA	Middle East and North Africa
MFIs	Microfinance Institutions
MOF	Ministry of Finance
MOSA	Ministry of Social Affairs
MW	Megawatt
NPLs	Non-Performing Loans
ODC	Cereals Office, *Office des Céréales*
OMPP	Office of Marine Trade and Ports, *Office de la Marine Marchande et des Ports*
ONMP	National Observatory of Public Procurement, *Observatoire National des Marchés Publics*
PDO	Program Development Objective
PE	Political Economy
PIM	Public Investment Management
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PIMA	Public Investment Management Assessment
PFM	Public Finance Management
PforR	Program-for-Results
PLR	Performance Learning Review
PMT	Proxy Means Test
PNAFN	National Assistance Program to Families in Need, *Programme Nationale d'Aide aux Familles Nécessiteuses*
PPP	Public-Private Partnership
FDI	Foreign Direct Investment
LDP	Letter of Development Policy
PSIA	Poverty and Social Impact Analysis
PV	Photovoltaics
RE	Renewable Energy
SBA	Stand-by Agreement
SCD	Systematic Country Diagnostic
SDR	Special Drawing Rights
SMEs	Small and Medium Enterprises
SOE	State Owned Enterprise
SOTUGAR	Tunisian Guarantee Company *Société Tunisienne de Guarantie*
SSN	Social Safety Net
STAM	Tunisian Society of Handling and Maintenance, *Société Tunisienne d'Acconage et de Manutention*
STEG	Tunisian Gaz and Electricity Company, *Société Tunisienne d'Electricité et de Gaz*
STIR	Tunisian Company for Refining Industries, *Société Tunisienne des Industries de Raffinage*
TA	Technical Assistance
TND	Tunisian Dinar
TRP	Tunisian Renewable Plan
TTN	Tunisia Trade Net
TUNEPS	Tunisia Online E-Procurement System
UCT	Unconditional Cash Transfer
UGO	Management by Objective Unit, *Unité de Gestion par Objectif*
UGTT	Tunisian Labor Union, *Union Générale Tunisienne du Travail*
UNCITRAL	United Nations Commission on International Trade Law
UTICA	Tunisian Union of Industry, Trade and Handicraft, Union *Tunisienne de l'Industrie, du Commerce et de l'Artisanat*
R&D	Research and Development
USAID	United States Agency for International Development
VAT	Value Added Tax
WBG	World Bank Group
WDR	World Development Report

Regional Vice President:	Hafez Ghanem
Practice Group Vice President:	Jan Walliser
Country Director:	Marie Françoise Marie-Nelly
Senior Practice Directors:	Carlos Felipe Jaramillo, Ceyla Pazarbasioglu-Dutz
Practice Managers:	Kevin Carey, Jean Pesme
Task Team Leaders:	Abdoulaye Sy, Fadwa Bennani

REPUBLIC OF TUNISIA
INVESMENT, COMPETITIVENESS AND INCLUSION
DEVELOPMENT POLICY FINANCING

TABLE OF CONTENTS

Tables

Figures

The Investment, Competitiveness and Inclusion DPF is prepared by a World Bank Group team consisting of Abdoulaye Sy (GMTMN, TTL), Fadwa Bennani (GFCMW, TTL), Moez Cherif (GEE05), Tu Chi Nguyen (GPV06), Dalia Al Kadi (GMTMN), Natsuko Obayashi (GMTMN), Mohamed Hisham El Shiaty (GFCM1), Mariem Malouche (GFCMW), Jade Salhab (GFCMW), Mouna Hamden (GFCM1), Dorra Berraies (GFCMW), Nomsa Lutepo Kachingwe (GFCMW), Carine Clert (GSP05), Yuko Okamura (GSP05), Mehdi Barouni (GSP05), Emil Daniel Tesliuc (GSP05), Angela Elzir (GSP05), Thomas Walker (GSP06), Vasco Molini (GPVP05), Lea Hakim (GMTMD), Mohammed Khaled (CF3A3), Gabriel Sensenbrenner (GFCMW), Jaafar Sadok Friaa (MNC01), Fadila Caillaud (MNC01), Emmanuel Pinto Moreira (GMTMN), Abdoulaye Keita (GGOPM), Taoufiq Bennouna (GEN05), Ousmane Maurice Megnan Kolie (GGOMN), Mehdi El Batti (GGOMN), Simon Carl O'Meally (GGOMN), Sadok Ayari (MNAEC) and Elena Segura (LEGAM). Loan disbursement advice is provided by Eric Ranjeva (WFACS), Georges Tony Abou Rjaily (WFACS). Outstanding administrative support is provided by Leila Chelaifa, Narjes Jerbi, Rekaya Ben Mahmoud (MNCTN), and Muna Abeid Salim (GMTMN). The operation is prepared under the overall guidance of Kevin Carey (Practice Manager, GMTMN), Jean Pesme (Practice Manager, GFCMW), Erik Fernstrom (Practice Manager, GEE05), Hana Brixi (Practice Manager, GSP05), David Robalino (Manager, GPSJB), Yolanda Tayler (Practice Manager, GGOPM), Tony Verheijen (Country Manager, Tunisia, MNCTN), Paloma Anos Casero (Director, GMTD1), Najy Benhassine (Director, GFCDR), Lucio Monari (Director, GEED1), Lynne Sherburne-Benz (Director, GSJD1), and Marie Francoise Marie-Nelly (Country Director, MNC01). The team is thankful to Government of Tunisia officials, in particular to Mr Zied Laadhari, Minister of Development, Investment and International Cooperation (MDIIC), for guiding this work and for their productive cooperation.

SUMMARY OF PROPOSED LOAN AND PROGRAM
REPUBLIC OF TUNISIA
INVESTMENT, COMPETITIVENESS AND INCLUSION
DEVELOPMENT POLICY FINANCING

Borrower	Republic of Tunisia
Implementation Agency	Ministry of Development, Investment and International Cooperation
Financing Data	IBRD loan; Amount: EURO 413.4 million (US$500 million equivalent)
Operation Type	The proposed operation is a standalone single-tranche operation
Pillars of the Operation and Program Development	The program development objective is to: (i) remove barriers to investment, trade and entrepreneurship; (b) move towards a more efficient, sustainable and inclusive energy sector; and (c) promote greater economic and social inclusion.
Result Indicators	**PDO 1. Removing barriers to investment, trade and entrepreneurship** • Number of investment entry authorizations eliminated or simplified. Baseline: authorizations eliminated (0); simplified (0) (2017). Target: authorizations eliminated (10); simplified (17) (2019). • “Foreign Trade Certificate”, “Merchandise Loading Certificate”, and “Notice of Arrival of Imported Merchandise” trade procedures are dematerialized (2019). • Time to issue the “Foreign Trade Certificate”, average number of days: Baseline: 7 days (2017); Target: 3 days (2019). • Share of public entities conducting their procurements through TUNEPS. Baseline (2017): Ministries (84%); SOEs (45%) (2017); Parastatals (34%); Target (2019): Ministries (100%); SOEs (60%); Parastatals (50%). • Share of public contracts awarded to SMEs. Baseline: 17% (based on a non-random sample of 32 public entities) (2017). Target: 20% (based on a random sample of public entities) (2019). • E-registry for movable collateral is established and operational (2019). • Volume of SME loans guaranteed by Sotugar. Baseline: TND 437 million (2017); Target: TND 500 million (2019). **PDO 2. Moving towards a more efficient, sustainable and inclusive energy sector** • Electricity and gas subsidies, % of GDP. Baseline: 1.2% (2017). Target: 1% (2019). • Transmission and distribution losses of the power utility, % of generated power. Baseline: 16.4% (2016). Target: 12.5% (2019). • Rate of collection of bills (electricity and gas), % of total bills. Baseline: 76% (2016). Target: 82% (2019). • Solar power capacity of private sector owned projects selected under the concession scheme. Baseline: 0 MW (2017). Target: 300 MW (2019). **PDO 3. Promoting greater economic and social inclusion** • Targeting model is applied to the database of beneficiaries of the two main social assistance programs (PNAFN and AMG-I and II) and the waiting list (2019). • Design of cash transfer program for children’s human capital formation is finalized and submitted to Council of Ministers (2019). • Volume of microcredits disbursed towards income generating activities (of which for women). Baseline: TND 731 million (TND 372 million) (2017). Target: TND 1,175 million (TND 600 million) (2019).
Overall risk rating	High
Climate and disaster risks	Are there short and long-term climate and disaster risks relevant to the operation (as identified as part of the SORT environmental and social risk rating)? No
Operation ID	P161483

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

INVESTMENT, COMPETITIVENESS AND INCLUSION DEVELOPMENT POLICY FINANCING

1. INTRODUCTION, COUNTRY CONTEXT (INCLUDING POVERTY DEVELOPMENTS)

1. **The proposed Investment, Competitiveness and Inclusion Development Policy Financing (ICI DPF), in the amount of Euro 413.4 million (equivalent to US$500 million), is a standalone single-tranche operation aimed at supporting key actions in the Government of Tunisia reform program to address the fragile economic and social situation.** The proposed operation supports the Government's Five-Year Development Plan for 2016-2020 aimed at boosting inclusive and sustainable private sector-led growth and job creation. The proposed operation is motivated by an urgent need to deepen the implementation of structural reforms aimed at: (a) shifting the economy towards a growth model underpinned by private investment, competitiveness and productivity; (b) improving the deteriorated macroeconomic and fiscal situation; and (c) modernizing the social safety nets (SSN) and promoting productive economic inclusion.

2. **Tunisia's growth performance over the last seven years has been weak and has not delivered on much needed private sector jobs.** Economic growth has been low and mostly been driven by consumption while investment, exports and productivity growth have been low. On the factor side, the contribution of capital formation to GDP growth remains extremely low compared to the 1990s, when parts of the economy were liberalized. As a result, unemployment is high (15.5 percent in 2017), particularly among women (22.6 percent), young university graduates (31 percent), and the population in the inland regions of the country. Accelerating the pace of growth will be critical to reducing unemployment in the medium term.

3. **Urgent and sustained policy actions are also needed to stabilize the macroeconomic situation.** The political transition, recurrent social tensions, domestic and regional security shocks, combined with delays in implementing the needed reforms have negatively affected production and exports. In addition, the increase in public sector hiring and salaries in response to high unemployment and social tensions has led to a sharp rise of the public wage bill from 10.7 percent of GDP in 2010 to 14.7 percent of GDP in 2017, which now represents more than 60 percent of tax revenues. These developments, with monetary policy remaining accommodative, have in turn weakened Tunisia's macroeconomic situation with the fiscal and current accounts deteriorating sharply (6 and 10 percent of GDP, respectively, in 2017). The large current account deficit, along with depressed FDI and the large Central Bank interventions in the foreign exchange market, have led to a rapid fall in gross international reserves, which dropped to 3.1 months of import by end-2017 and stood on average at 75 days in mid-May 2018. Consequently, the dinar has depreciated, which - in

combination with increases in wage, some administered prices and the value-added tax (VAT) - has fueled inflation over the last year.

4. **The lack of economic opportunities, combined with rising inflation, contributes to household vulnerability, and poses a risk to social stability.** While the poverty incidence was halved in the decade before the 2011 Revolution, disparities among regions and age groups have persisted or widened. Just as important, 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 price of essential goods.

5. **The proposed operation will provide timely financing in support of the Government's commitment to accelerating the reform momentum. In the absence of the financing and reforms supported by the proposed operation, the risks to external and fiscal stability and therefore to Tunisia's economic and social stability would be significant.** A Eurobond issuance of up to US$1 billion equivalent has been approved by Parliament but its timing remains uncertain and sensitive to market and domestic macroeconomic conditions. The proposed operation, along with the recent approval of the second IMF Extended Fund Facility (IMF EFF) program review, will therefore provide important market signal to improve Tunisia's international market access. In addition, with international reserves having declined rapidly since the beginning of the year to extremely low and vulnerable levels (hovering between 75 and 80 days of import cover), the timing of the proposed operation is critical to help meet Tunisia's reserves and budget needs, particularly given that the projected improvement in tourism receipts would only fully materialize by the end of the summer and phosphate production remains volatile (both sectors are important for growth, export and foreign exchange receipts). Without such financing and the underlying reforms, the external and fiscal situation will remain highly vulnerable to shocks which could lead to an economic contraction and fuel high inflation that would hurt severely the poor and low-income households.

6. **The proposed operation supports mutually reinforcing reform actions aimed at improving private investment, competitiveness and entrepreneurship, energy sector efficiency and sustainability, and economic and social inclusion.** The proposed operation will help accelerate reforms aimed at removing barriers to investment, improving the efficiency and transparency of trade procedures, and promoting the development of SMEs, particularly young and less privileged SMEs. Furthermore, by focusing on critical reforms in the energy sector, the proposed operation will contribute to reducing the costly and distortive energy subsidies amid rising international prices and a depreciated currency; improving the commercial performance of the state-owned power utility whose financial situation has deteriorated; and creating space for private investment, particularly in renewable energy. Finally, the proposed operation will support the Government's efforts to advance safety net reforms, which are critical to mitigating the impact on poor and vulnerable populations of potential shocks arising from macroeconomic and fiscal reforms or exogenous factors. The proposed operation is part of a broader engagement and is complemented by TA and other operations to support reform design and implementation.

7. **While the Government has initiated a series of legislative reforms to stimulate private sector growth and job creation, there is a need to accelerate implementation of concrete actions to boost private investment, trade and entrepreneurship.** Implementation of the legislative reforms and the market response have been slow, and there is a need to create more space for the private sector to participate and invest in productive and competitive sectors. To this end, the Government is committed to reducing barriers to investment in key sectors as part of the implementation of the Investment Law, improving trade facilitation to reduce the time and cost to trade and improve the transparency of trade procedures, and enhancing access to markets and credit for SMEs. Promoting innovation and digital entrepreneurship will also be essential to creating new markets, increasing competitiveness, and improving productivity in the economy.

8. **In the energy sector, the Government's objective is to accelerate sector reforms given their impact on fiscal and current accounts, the need to address climate change, and the potential to attract sizeable investments.** These reforms will entail reducing energy subsidies while mitigating potential negative impacts on the poor and vulnerable; as well as improving the performance of the power utility, and the energy mix. The Government will implement its energy subsidy reduction policy – aiming to reach full elimination of energy subsidies by 2022 (IMF EFF program) – starting with electricity and tariff adjustments in 2018 (under the proposed operation), combined with more systematic application of the existing fuel price adjustment mechanism (anchored in the IMF EFF program). To implement its existing performance contract with the state, the power utility will take actions to improve its technical and commercial performance and reduce losses. On renewable energy, the Government is firmly committed to scaling up and implementing its renewables plan through concession schemes, and to making greater use of public-private partnerships (PPPs) for key investments. The Government also plans to establish an energy sector regulatory authority to improve the transparency of tariff structures and encourage greater private sector participation.

9. **The Government also recognizes the need to modernize and improve the targeting of social safety nets (SSN), and to promote access to microfinance among youth, women and populations in inland regions**. Since 2010, the Government has significantly expanded the coverage of SSN programs and the value of cash transfers: between 2010 and 2017, the number of beneficiaries rose from 108,000 to 242,000 households and cash transfers rose from TND 75 per household every quarter to TND 150 per household per month (equivalent to 25 percent of poverty threshold). Further, in January 2018, in the context of establishing the national social protection floor and rising inflation, the Government announced that cash transfer amounts would be increased by another 20 percent (effective April 2018) to support the purchasing power of poor and low-income households. The Government also aims to improve the targeting and fiscal efficiency of safety nets and to strengthen their role in promoting investment in children's human capital. In addition, the Government seeks to promote greater access to microfinance for income-generating activities, with an emphasis on locations and socio-economic groups with fewer economic opportunities.

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

Growth, inflation and unemployment

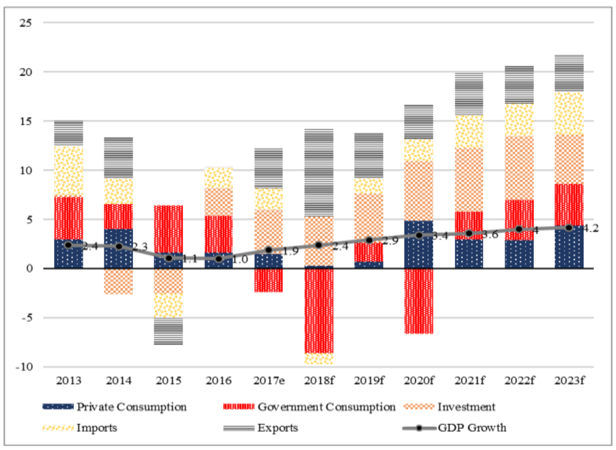
10. **Tunisia's growth performance over the past seven years has been weak despite recent modest acceleration.** The political transition, recurrent social tensions, security shocks, the political and security situation in MENA (including in neighboring Libya), and delays in implementing the needed reforms have negatively affected the Tunisian economy. Economic growth averaged 1.5 percent per annum in 2011-17 compared to 4.5 percent per annum in 2006-10. Since 2016, growth has recovered modestly, supported by improvement in the domestic security situation and by stronger performance in services and export-oriented manufacturing sectors. The economy grew by 1.9 percent in 2017 compared to 1.0 percent in 2016 and 1.1 percent in 2015. Growth in 2017 was driven mainly by agriculture (+2.5 percent), services (+4.1 percent), and export-oriented manufacturing. However, overall industrial output and non-manufacturing industries (phosphate, oil and gas) have not fully recovered despite a gradual depreciation of the dinar, due to social movements in mining regions, low oil prices and reduced investment in exploration. Moreover, the contribution of investment, exports and productivity to growth are significantly below their pre-Revolution levels.

11. **Inflation has accelerated, prompting the Central Bank to begin tightening monetary policy.** Inflation has accelerated to 7.7 percent (year-on-year) in April 2018, from 6.4 percent in December 2017 and 4.2 percent in December 2016, driven by depreciation of the dinar, administered energy price increases, VAT increases and credit to households. In the face of these rising inflationary pressures and with key interest rates negative in real terms, the Central Bank of Tunisia (CBT) increased its policy rate three times between April 2017 and March 2018, raising it from 4.25 percent to 5.75 percent. CBT has communicated its readiness to further tighten monetary policy in 2018 if inflationary pressures persist, in order to maintain key interest rates in positive territory.

12. **Monetary tightening has not yet managed to curb record bank refinancing; however, the cost of liquidity has risen slightly in recent months.** Weak economic activity and limited deposit growth have tightened the liquidity of banks. Pressure on liquidity has been exacerbated by the Government's deficit financing in the domestic market, net foreign asset outflows from the financial system, and CBT interventions in the foreign exchange market. Central Bank refinancing reached TND 13 billion at the beginning of March 2018 against TND 9.2 billion, on average, in 2017. This prompted the CBT to widen its interest rate corridor from 50 to 200 basis points in December 2017. The cost of liquidity has risen in recent months: the interbank rate rose from 5.4 percent at end-December to 5.75 percent at the beginning of March 2018, and commercial bank rates for prime borrowers range between 8 and 12 percent. Furthermore, the impact of monetary policy is undermined by the high prevalence of cash transactions and the significant size of the informal economy (exacerbated by spillovers from Libya), both of which raise the demand for cash in circulation and lower the money multiplier.

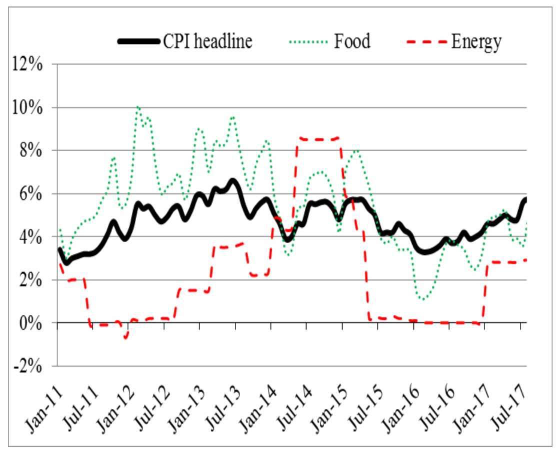
13. **There has been limited progress toward job creation – one of the key demands of the 2011 Revolution.** Unemployment is high, particularly for youth, women and people living in the inland regions. Although unemployment has declined from its peak of 19 percent in 2011, just after the Revolution, to 15.5 percent in 2017, it remains above the 2010 level of 13 percent. Labor force participation is around 50 percent, due mainly to the very weak participation of women (27 percent compared to 69 percent for men). This low performance is driven by weak job creation in the post-Revolution period and a net loss of almost 12,000 jobs stemming from the terrorist attacks in the Bardo museum in Tunis and on a resort in Sousse in 2015. Net job creation picked up in 2016 and 2017, with a modest gain of 34,700 and 45,500 jobs, respectively, during the same period, while the working age population increased by 80,000.

Figure 1: Contribution to GDP Growth (in percent)



Source: IMF and Tunisian authorities

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



Source: National Institute of Statistics

Fiscal policy and balance

14. **Tunisia faces large fiscal deficits and rapidly increasing public debt.** The fiscal deficit (including grants) averaged 5.7 percent of GDP in 2012-16. It reached 6.1 percent of GDP in 2017, 1 percentage point of GDP above the initial 2017 Budget, due mainly to higher wage bill and energy subsidy spending. Consequently, public debt reached 71 percent of GDP in 2017 compared to 40 percent of GDP in 2010.

15. **The Government aims to gradually reduce the deficit and stabilize and reverse the debt dynamics in the medium term. Achieving these objectives will require strong and sustained policy implementation.** The programmed fiscal effort (IMF EFF program) is anchored in an improvement of 1.9 percent of GDP in the cyclically adjusted structural fiscal balance over 2018-20. In 2018, the Government aims to keep the deficit at around 5.2 percent of GDP (IMF EFF program) through higher tax revenues (yield close to 2 percent of GDP)[1];

[1] The 2018 Budget introduced the following key measures: (a) increase in excise taxes for alcohol, cars and tobacco (expected yield: 0.8 percent of GDP according to IMF staff calculations); (b) increase of the two main VAT rates (18 percent and 6 percent) by 1 percentage point (expected yield: 0.6 percent of GDP); and (c) introduction of a solidarity contribution of one percent on income (expected yield: 0.3 percent of GDP).

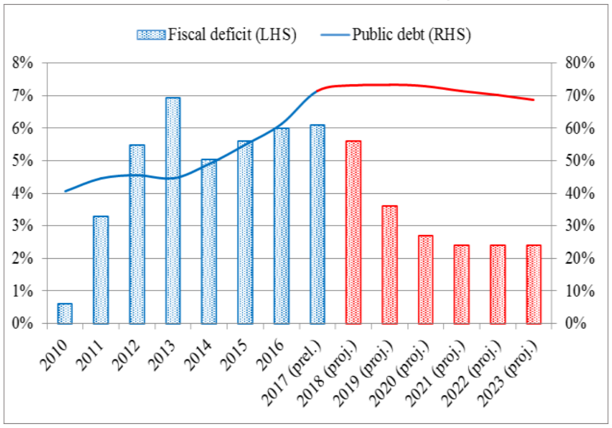
as well as by containing energy subsidy costs, lowering wage bill growth, reforming pensions and reducing transfers to the public pension scheme. The Government also intends to contain fuel subsidy costs by more systematically applying the existing fuel price adjustment mechanism (quarterly adjustments) and by extending subsidy reduction to other energy products (such as electricity and natural gas), particularly for larger and richer consumers (see section 4).

16. **Notwithstanding the steps taken by the Government to contain energy subsidies in 2018, rapidly rising international oil prices constitute significant fiscal risks and call for continued adjustment of domestic energy prices.** The Government increased fuel prices in January and April 2018 in line with the quarterly application of the fuel adjustment formula. However, the adjustments in January (under the second review of the IMF EFF) were below what the formula would have suggested. Electricity and gas tariff adjustments in 2018 (see section 4.2) will generate fiscal savings amounting to TND 213 million (0.2 percent of GDP). The Government has set up an inter-ministerial task force on energy subsidy reform to monitor fiscal risks associated with fluctuations in oil prices and to propose measures necessary to remain within budgetary targets.

17. **In January 2018, the Government announced additional support to poor and vulnerable families.** This support, which became effective in April 2018, includes a 20 percent increase in the cash transfer amount (to TND 180 per month per family). In addition, the minimum pensions of retirees were raised to TND 180 per month.

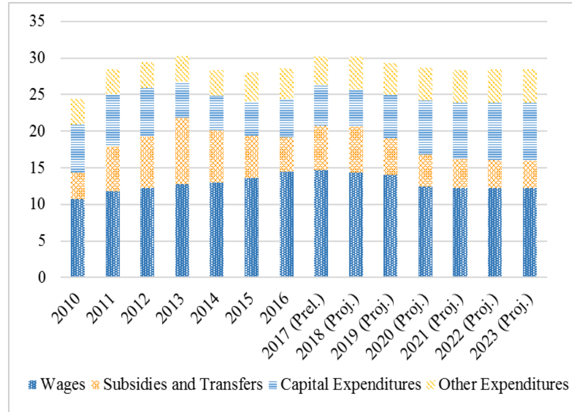
18. **The public sector wage bill, at 14.7 percent of GDP, is central to understanding the lack of fiscal space. Wage negotiations with unions, scheduled for 2018, may add upward pressure on the wage bill.** Public sector employment increased by 24 percent in 2011-2015, and the wage bill has doubled in nominal terms since 2011. To contain the wage bill, the Government launched an early retirement program targeting up to 6,000 civil servants as well as a voluntary departure program with a separation package, targeting about 10,000 civil servants in 2018, and set a cap of 3,000 new hires. However, preliminary data suggests that take-up of the departure programs is low. In addition, these programs will not generate near-term fiscal savings on the consolidated budget as retirees move into the relatively generous pension system. To limit wage growth, the Government is committed to not grant new wage increases "unless growth surprises significantly on the upside" (IMF EFF program).

Figure 3: Fiscal Deficit and Public Debt (in percent of GDP, deficit excl. grants)



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

Figure 4: Public Expenditures (in percent of GDP)



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

19. **The Government – working together with the main workers' unions (UGTT) and the private sector association (UTICA) – has taken steps to prepare a pension reform proposal with urgent measures to tackle the short-term deficit and liquidity needs of the system. The proposal fails to tackle the medium-term financial sustainability and equity of the system and may contribute to downward pressure on job creation and formality.** Faced with a deficit of the public pension scheme amounting to 0.4 percent of GDP and rapidly growing (private pension scheme deficit amounts to 0.6 percent of GDP), a tripartite commission (composed of Government, UGTT and UTICA) has prepared a reform proposal in which the retirement age and contribution rates would be increased gradually over a period of two to three years. In addition, the 2018 Budget Law introduced a solidarity tax - a one percent on income - that will, over the long term, finance the social security system but in the short term will be used to help lower the deficit of the pension system. This reform package, however, does not resolve the medium-term sustainability challenges of the system or correct existing inequities and distortions in incentives to work, hire and contribute. World Bank analysis shows that tackling these structural challenges will require adopting a medium-term view and reforming some key structural parameters, including: (a) penalty for early retirement; (b) benefit accrual rates; (c) expansion of the number of years of service used for pension calculation; and (d) design improvements to incentivize contributing in the system.

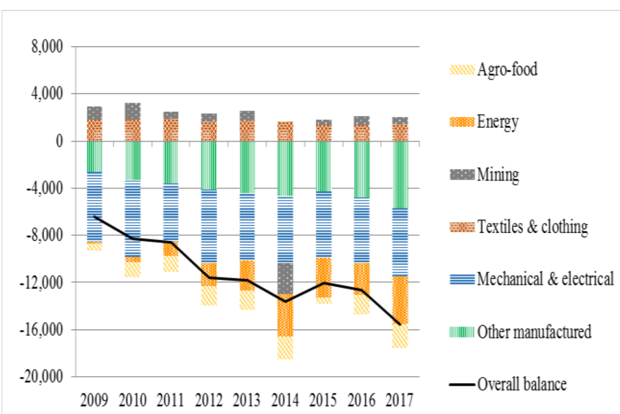
20. **Another source of fiscal risk is the contingent liabilities of state-owned enterprises (SOEs).** The exposure to credit risk from guarantees, on-lending, and Treasury loans to SOEs and public financial institutions amounted to around 14 percent of GDP in 2016. About 75 percent of this exposure stems from guarantees on external loans, of which the power utility accounts for 43 percent, followed by financial and banking institutions (18 percent), transport companies (12 percent), and the water and sanitation utilities (8 percent). Many SOEs were loss making in 2016, the year for which the latest aggregate SOE financial data are available. The 20 largest SOEs (excluding social security) had a total net loss of TND 1.3 billion in 2016 (1.5 percent of GDP), of which the 5 largest lossmakers were the Tunisian Gas and Electricity Company (*Société Tunisienne d'Electricité et de Gaz,* STEG) with 26

percent of losses; the national airline company TUNISAIR with 12 percent; the public transport company for Tunis (TRANSTU) with 10 percent; the phosphate company CPG with 8 percent; and the railway company with 5.7 percent. To strengthen management of contingent fiscal risks, the Government has launched implementation of its SOE reform strategy, aimed at improving the governance and oversight framework of public enterprises, as well as the technical, commercial and financial performance of the enterprises themselves. The Government has also included financial indicators in the performance contracts of four large SOEs, including STEG and the public refining company (STIR), and aims to complete the performance contract of TUNISAIR by December 2018 (a structural benchmark of the IMF EFF program).

Current account and external position

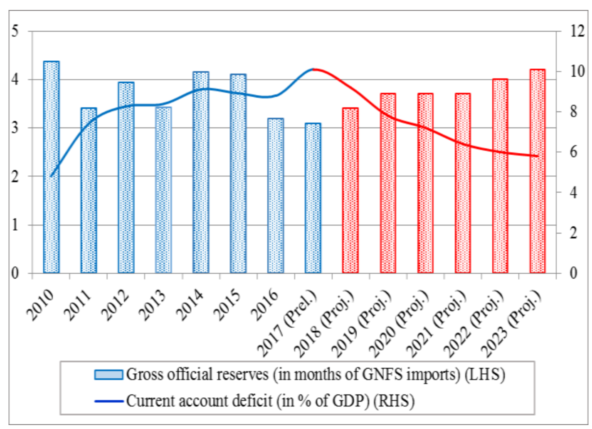
21. **There is an urgent need for the Government to improve the sustainability of the current account, rebuild reserves and contain inflation through an appropriate monetary, exchange rate and fiscal policy mix.** The current account has deteriorated to 10.1 percent of GDP in 2017, compared to 8.8 percent of GDP in 2016, with the trade deficit standing at 13.3 percent of GDP in 2017 compared to 11 percent in 2016. This situation, combined with depressed FDI (1.8 percent of GDP in 2017 against 4 percent, on average, in 2008-2010) and the large Central Bank interventions in the forex market, has led to a sustained loss of international reserves, which dropped to an average of 75 days of import cover in mid-May 2018. The IMF estimates that the real effective exchange rate remains overvalued by 10 to 20 percent at end 2017 despite recent depreciation. Further depreciation would need to be addressed through an appropriate monetary and fiscal policy mix to contain inflation while preserving fragile growth prospects in a context of low growth and high unemployment.

Figure 5: Trade by Product and Trade Balance (in TND million)



Source: National Institute of Statistics

Figure 6: Current Account Deficit and Reserves



Source: Central Bank, and IMF and World Bank staff projections

22. **Since the Revolution, Tunisia has relied mainly on concessional resources to finance its growing balance of payments deficit, and in recent years has enjoyed favorable international market access supported by bilateral guarantees. However, its sovereign credit ratings have deteriorated over the last year and a half.** Following the

issuance of bonds with a Japanese guarantee in 2014 and US guarantees in 2012 and 2014, the Government successfully raised US$1 billion by issuing a Eurobond without guarantees in early 2015, successfully raised US$500 million in the US market with a US guarantee in 2016, and raised Euro 850 million in Eurobonds in 2017. However, Tunisia continues to rely mainly on budget support operations from the IMF, European Union, World Bank, African Development Bank, and more recently from the KfW and AFD. Following a period of three years of overall stable sovereign ratings, several major agencies downgraded Tunisia in 2017 and 2018: Fitch to B+ from BB- in early February 2017, Ratings and Investment Information (R&I) from BB+ to BB in May, and Moody's from Ba3 to B1 in August 2017 and further to B2 in March 2018. The Government is planning a Eurobond issuance of up to US$1 billion in 2018.

Banking and financial sector

23. **The overall banking sector remains stable but suffers from low liquidity.** Non-performing loans (NPLs) remain high (15 percent in September 2017, against 15.8 percent in December 2014 and 13 percent in 2010) because of the weak economic situation and the legal obstacles to public banks selling, restructuring or liquidating collateral (mostly real estate). The Government is working on a legal framework that would simplify write-off rules and allow public banks to abandon claims (IMF EFF benchmarks).[2] On average, banks do not have major liabilities to foreign partners, and net open forex positions are small relative to capital. Credit risk remains a concern due to banks' exposure to interest rate-linked debt of households and corporations with uncertain earning potential, but the improving growth outlook should protect against deteriorating credit quality. Recent inspections of the seven largest private banks (IMF EFF structural benchmark) revealed no major vulnerabilities except the need to increase capital in one bank.

24. **In November 2017, the Financial Action Task Force (FATF) added Tunisia to its list of "gray" jurisdictions** due to significant deficiencies in its Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework. The EU Parliament echoed this decision by putting Tunisia on a similar list. Tunisia was also listed as a non-cooperative fiscal jurisdiction by the EU in December 2017. These actions carried significant risks for Tunisia and called for quick action to avoid a deterioration of investor confidence and a loss of correspondent banking services (CBS), which would especially hurt cross-border payments, trade finance, and remittances. In January 2018, the Government made a commitment to the EU Parliament to enact reforms and was delisted as a non-cooperating fiscal jurisdiction. The Government also agreed with FATF on an action plan to address deficiencies in its AML/CFT framework, and in February 2018 indicated its intention to accelerate implementation of the action plan.

[2] Public banks represent one third of financial system assets. One public bank still poses a fiscal risk on the order of 0.5 percent of GDP, should an a pending arbitration judgment go against the Government.

Table 1: Tunisia Selected Macroeconomic Indicators, 2015-2021

	2015	2016	2017 (Prel.)	2018 (Proj.)	2019 (Proj.)	2020 (Proj.)	2021 (Proj.)
Real Sector							
Real GDP growth (% change)	1.1	1.0	1.9	2.4	2.9	3.4	3.6
Gross National Savings (% of GDP)	12.5	13.4	12.4	14.0	15.7	16.6	18.0
Unemployment rate (% of active population)	15.4	15.5	15.5	15.0	14.8	14.6	14.2
Inflation (CPI, average)	4.9	3.7	5.3	7.0	6.1	5.2	4.3
Government finance (% of GDP)							
Total Revenues (including grants)	23.6	22.8	24.2	24.9	25.9	26.2	26.1
Total expenditure and net lending	28.8	28.7	30.2	30.1	29.3	28.7	28.3
Overall balance (excluding grants)	-5.6	-6.0	-6.1	-5.6	-3.6	-2.7	-2.4
Overall balance (including grants)	-5.3	-5.9	6.0	-5.2	-3.4	-2.5	-2.2
Gross public debt ratio (% of GDP)	54.8	61.2	71.3	73.1	73.3	72.9	71.4
Selected Monetary Accounts (Annual percentage change, unless otherwise indicated)							
Money and quasi-money (M2)	5.2	8.2	10.2	7.2	..	..	..
Credit to the economy	6.2	9.7	13.2	9.0	8.7	8.1	8.1
Policy interest rate (%, eop)	4.25	4.25	5.0	..	..	..	..
Balance of Payments (Percent of GDP, unless otherwise indicated)							
Current account balance	-8.9	-8.8	-10.1	-9.2	-7.8	-7.2	-6.4
Trade balance	-11.7	-11.4	-13.3	-13.0	-12.2	-11.6	-11.1
Exports (volume)	-2.8	0.2	4.1	8.9	4.6	3.5	4.3
Imports (volume)	-2.5	2.0	2.2	-1.1	1.6	2.3	3.3
Foreign Direct Investment, net	2.2	1.7	1.8	2.0	2.5	2.7	2.9
Gross reserves (US$ billion, eop)	7.4	5.9	5.7	6.3	7.0	7.1	7.4
in months of next year's goods and non-factor services imports 1/	4.1	3.2	3.1	3.4	3.7	3.7	3.7
External debt	64.9	72.2	80.1	83.7	85.5	84.5	83.5
Memorandum item							
Nominal GDP (TND million)	84,656	90,376	97,435	106,179	115,386	124,678	134,721
Nominal GDP (US$ billion)	43.2	42.1	40.3	40	42	44	47
GDP per capita (current US$)	3,884	3,690	3,496	3,463	3,569	3,691	3,855
Exchange rate, average (TND/US$)	2.00	2.10	2.4	..	..	..	..

Source: IMF and World Bank staff estimates

1/ End-of-year reserves over next year's imports

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

25. **Tunisia's modest economic recovery is expected to continue in 2018**, with GDP growth projected to reach 2.4 percent due to: (a) sustained agricultural growth under favorable climatic conditions; (b) faster recovery of manufacturing and tourism-related services stemming from improved cost competitiveness with depreciation of the dinar; (c) stable security conditions; and (d) improved mining production and exports, provided that production and transport disruptions are reduced.

26. **Faster and more sustained economic growth in the near term will require faster implementation of structural reforms to dampen the effect of monetary policy tightening and fiscal consolidation.** Monetary policy tightening will contribute to containing domestic credit growth, which reached 106 percent of GDP in 2017, of which 80 percent was for firms and households.[3] Fiscal tightening will also slow down public and household consumption and should be combined with actions to enhance the efficiency, inclusiveness and growth

[3] Industry accounted for 27.5 percent of loans amounting to 22 percent of GDP; households for 26.4 percent; and commerce for 16 percent of loans amounting to 8.5 percent of GDP.

impact of public spending and to protect the poor and vulnerable populations. Under the previous DPF, the World Bank has supported the Government's efforts to strengthen its public investment management (PIM) framework to better prioritize, select and oversee its investment projects. The proposed operation will support Government efforts to lay the ground for a targeted expansion of cash transfers to support children's human capital (see section 4.2) in the context of establishing the national social protection floor. Structural reforms to strengthen the business environment and improve competitiveness (see section 4.2) are critical to accelerating and sustaining growth and shifting towards a greater contribution of investment, exports and productivity to growth in the near and medium term.

Fiscal policy

27. **Reducing the deficit in the near term will require sustained efforts to improve tax fairness and collection, contain the wage bill, reform energy subsidies and reduce risks from the pension system and SOEs.** Achieving the ambitious revenue targets will require stronger tax administration, including the creation and operationalization of the large taxpayers' unit (IMF EFF structural benchmark). To contain growth of the wage bill, the Government has committed to strict rules on new hiring and to the implementation of voluntary and negotiated departure programs (IMF EFF program).[4] Furthermore, amid rising oil prices and depreciation of the dinar, advancing energy subsidy reform is critical to contain the deficit and create space for needed social spending (see section 4.2). Reforming the pension system to reduce medium-term liabilities and improve equity, and reducing the fiscal risks from SOEs (see section 4.2), are critical for containing the deficit in the short term and for medium-term fiscal sustainability.

Inflation and monetary policy

28. **Upward inflationary pressures are expected in 2018, followed by a slow return to moderate inflation in the medium term as the impact of monetary policy tightening materializes.** Inflationary pressures will be driven in the short term by the trend of dinar depreciation; the 2018 VAT rate increases; the increase in prices of certain products, including fuels, tobacco, and telecom services; as well as credit growth and supply bottlenecks. It is projected that inflation in 2018 will average 7 percent under implementation of the Government's planned fiscal, monetary and exchange rate policies. In the medium term, inflation is then forecast to slow to around 4 percent by 2021 on the back of fiscal adjustment, lower credit growth, and the dinar's adjustment to the level associated with economic fundamentals.

---

[4] The Government will also will eliminate the use of tax credits for public wages entirely starting in 2019.

Table 2: Tunisia Key Fiscal indicators 2015-2021 (in percent of GDP)

	2015	2016	2017 (Prel.)	2018 (Proj.)	2019 (Proj.)	2020 (Proj.)	2021 (Proj.)
Overall balance (excluding grants)	**-5.6**	**-6.0**	**-6.1**	**-5.6**	**-3.6**	**-2.7**	**-2.4**
Overall balance (including grants)	**-5.3**	**-5.9**	**6.0**	**-5.2**	**-3.4**	**-2.5**	**-2.2**
Primary balance (excl grants, cash basis)	-2.0	-4.4	-4.1	-2.9	-1.1	0.0	0.2
Total revenue (including grants)	**23.6**	**22.8**	**24.2**	**24.9**	**25.9**	**26.2**	**26.1**
Tax Revenues	21.8	20.7	21.7	22.4	23.6	23.9	23.9
Non-tax revenues	1.4	2.0	2.3	2.1	2.1	2.0	2.0
Grants	0.3	0.1	0.2	0.3	0.2	0.2	0.2
Total expenditures and net lending	**28.8**	**28.7**	**30.2**	**30.1**	**29.3**	**28.7**	**28.3**
Current expenditures	23.3	23.3	24.7	25.2	23.5	21.3	20.6
Wages and salaries	13.6	14.5	14.7	14.3	14.0	12.4	12.2
Goods and services	2.0	1.9	1.6	1.5	1.5	1.5	1.5
Interest payments	1.9	2.2	2.3	2.6	2.5	2.7	2.6
Transfers and subsidies	5.7	4.6	6.1	6.4	5.2	4.4	4.0
Other expenditures (non-allocated)	0.0	0.0	0.0	0.3	0.4	0.4	0.3
Capital expenditures and Net lending	4.7	5.3	5.5	5.0	5.8	7.4	7.7
Float 1/	1.7	-0.6	-0.2	0.0	0.0	0.0	0.0
Overall balance (cash basis)	**-3.6**	**-6.4**	**-6.2**	**-5.2**	**-3.4**	**-2.5**	**-2.2**
General Government Financing	**3.6**	**6.4**	**6.2**	**5.2**	**3.4**	**2.5**	**2.2**
External (net)	5.1	2.9	4.9	6.4	3.6	2.5	2.6
Domestic (net)	-1.5	3.5	1.3	-1.2	-0.2	0.0	-0.4
Of which : privatization and sale of confiscated assets 2/	0.1	0.6	0.0	0.0	0.0	0.0	0.0

Source: IMF and World Bank staff estimates
1/ Difference between the cash and accrual central government overall deficit data calculated at the end of the period. For actual data, this line also includes
payments for which payment has been ordered but the corresponding amounts have not been withdrawn from the treasury accounts. A negative sign
2/ Includes mostly the sale of assets confiscated from the former regime's personal assets

External position

29. **The current account deficit is expected to slowly narrow in the medium term, which, combined with exchange rate flexibility and lower CBT forex interventions, will help to rebuild reserves.** Under the assumptions of greater exchange rate flexibility, tighter fiscal and monetary policy and gradual implementation of structural reforms, the current account deficit is projected to progressively narrow from 10.1 percent of GDP in 2017 to 9.2 percent in 2018 and to average 7 percent of GDP in 2019-21. This will be driven mainly by the growth in tourism receipts, as well as manufacturing exports, notably agriculture and agribusiness, textile, mechanical and electrical products, which are expected to grow in line with growth prospects in Europe and competitiveness gains resulting from the depreciation of the dinar. Oil and gas exports are projected to continue their declining trend in the near term, with extraction from new sites only partially offsetting extraction in older, less productive sites. Phosphate and energy exports may slowly recover if social tensions diminish. Import demand, however, is not expected to decline much in response to dinar depreciation due to the price inelasticity of many imports, including energy and capital goods. FDI is also expected to recover gradually depending on social and security conditions, improved investor confidence, the opening of sectors to foreign investment and the simplification of business procedures. Gross reserves are forecast to gradually grow from 3.1 months of imports in 2017 to 3.4 months in 2018 and an average of 3.7 months in 2019-22, aided by reduced foreign

exchange interventions by the Central Bank (new monthly indicator under the IMF EFF program from the second review onward) and greater exchange rate flexibility.

Table 3: External Financing Needs 2016-2019 (in US$ million)

	2016	2017 (Prel.)	2018 (Proj.)	2019 (Proj.)
Current account deficit	3,694	4,048	3,689	3,071
External medium and long-term debt amortization	1,492	2,298	2,067	1,818
Short-term debt	6,694	6,694	6,657	5,934
Total requirements	**11,880**	**13,040**	**12,413**	**10,822**
FDI and portfolio investment, net	638	705	796	1,116
Disbursements	2,463	4,435	4,475	2,798
Central Government 1/	1,833	3,379	3,893	3,333
Of which				
Market issuance	497	905	1,000	1,050
IMF	316	315	1,006	1,017
World Bank	42	500	500	550
EU	51	423	456	100
AfDB	477	144	91	200
Central Bank 2/	0	434	0	
Corporate 3/	629	622	583	
Short term debt 4/	6,694	6,657	6,410	6,240
Other flows net (incl. drawdown in commercial banks NFA)	1,424	853	1,377	917
Total resources	**11,219**	**12,650**	**13,058**	**11,071**
Drawdown in gross reserves	532	259	-644	249
Total Financing	**11,751**	**12,888**	**12,413**	**10,822**

Source: IMF and World Bank staff estimates

1/ Central Government includes IMF purchases made available for budget support.

2/ Central Bank includes IMF purchases made available for BOP support.

3/ Includes public and private enterprises.

4/ Stock of short-term debt outstanding at the end of the previous year.

Debt sustainability analysis

30. **Public debt has risen steadily in the post-Revolution period, reaching 71.3 percent of GDP in 2017, up from 40 percent in 2010,** and is now above the debt burden benchmark for emerging markets. In parallel, external debt has increased to 80 percent of GDP in 2017 from 48 percent of GDP in 2010. The increase in debt levels reflects the impact of expansionary fiscal policy as well as security shocks, widening current account deficits, currency depreciation, and low growth. Under current baseline scenarios of low and slowly recovering growth over 2018-2019 and moderate fiscal consolidation in 2018, public debt is expected to peak at 73.3 percent of GDP in 2019 before declining to 70 percent of GDP by 2022. In the same scenario, external debt would peak at 85.5 percent of GDP in 2019 and decline slowly to 81 percent of GDP by 2022. Gross financing needs are forecast at 6.7 percent of GDP by 2022 compared to 10.8 percent in 2017.

31. **The public debt sustainability analysis (DSA) shows that public debt dynamics are vulnerable to a slower fiscal adjustment path, lower growth, the realization of contingent liabilities or a large depreciation of the exchange rate (see Annex 4).** Tunisia enjoys relatively long maturity and low average interest rates on its debt (average nominal interest rates were 4.1 percent for overall debt, 6.6 percent for domestic debt and 2.8 percent

for foreign-currency denominated debt in 2017), reflecting its reliance on foreign financing and multilateral donors. However, about 67 percent of public debt is denominated in foreign currency. Further, contingent liabilities due to ailing SOEs and pensions could increase financing needs and pose another substantial source of risk. The results of the latest DSA for public debt suggest that under most scenarios, negative shocks to growth (including higher fiscal deficit, change in the real interest rate or exchange rate, or realization of contingent liabilities), the public debt-to-GDP ratio would peak at 90 percent under the most severe shock.

Risks to the macroeconomic outlook

32. **The downside risks to the outlook remain high.** These risks relate mainly to the domestic political, socio-economic and security situation, in addition to the security situation in the MENA region, particularly in neighboring countries. While the Government has deployed resources to improve the security situation, the high level of youth unemployment, notably in the hinterland, along with weak economic conditions and rising inflation, may result in social tensions – one of the main domestic risks to the country since the Revolution. The risks associated with reform delays are elevated due to the difficulties of mobilizing and maintaining sufficient support for the reforms.

Overall assessment of macroeconomic policy stance

33. **Overall, the country's macroeconomic policy framework is adequate but remains fragile highlighting the importance of strong policy anchors and international support**. The policy mix in 2017 was essentially procyclical monetary and fiscal policy despite limited buffers, and steadfast implementation of corrective measures should continue. The Government is committed to fiscal consolidation and macroeconomic stability, including through the IMF EFF program. The World Bank and several other bilateral and multilateral institutions (the EU, AfDB, EBRD, KfW and AFD) are providing technical and financial support to accelerate the implementation of structural reforms.

2.3 IMF RELATIONS

34. **The second IMF EFF program review was approved by the IMF Board on March 23, 2018. The program will move to quarterly reviews with the aim of improving monitoring and performance given the elevated macroeconomic vulnerabilities.** Following the expiration of the two-year Stand-by Agreement (SBA)[5] in December 2015, the IMF and Tunisia signed a four-year EFF in the amount US$2.8 billion, of which about US$320 million was disbursed following approval in May 2016. The IMF EFF program's main goals are to: (a) consolidate macroeconomic stability, in particular by containing the wage bill and laying the groundwork for civil service reform, advancing tax and energy subsidies reforms, furthering exchange rate flexibility, reducing the current account deficit and rebuilding reserves; (b) promote financial intermediation through the adoption and

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

implementation of banking legislation (bankruptcy, banking and Central Bank laws), continued progress in restructuring public banks, and lifting legal barriers to the resolution of non-performing loans; and (c) improve the investment climate. While the EFF initially planned semi-annual reviews, reform delays significantly delayed program implementation, so the first review was concluded and approved by the IMF Board on June 12, 2017, thirteen months following approval of the program, and the second review followed nine months later. The IMF program provides a strong policy anchor for macroeconomic stability, and more frequent monitoring is critical for strong program implementation given the elevated macroeconomic risks. To this end, the Government and the IMF have agreed to move to quarterly reviews and to introduce a new monthly indicative target to facilitate monitoring of the reserve cover on net Central Bank foreign exchange interventions.

3. THE GOVERNMENT'S PROGRAM

35. **The Government's program is underpinned by the development vision and reform agenda set out in the *Note d'Orientation Stratégique*[6], the Five-Year Development Plan for 2016-2020, and the Government's Economic and Social Roadmap for 2018-2020.** The *Note d'Orientation Stratégique* lays out the Government's economic and social vision for the country, placing strong emphasis on the importance of the private sector for boosting job creation and driving inclusive and sustainable economic growth. Building on the *Note d'Orientation Stratégique*, the Five-Year Development Plan specifies a program of reforms that rests on five axes:

- **Axis 1 – Financing the economy.** This axis aims to: (a) strengthen the regulatory and supervisory framework for the banking sector, including adoption of a new Banking Law and Central Bank Law; (b) modernize the governance of state-owned banks and improve the resilience of the banking sector; (c) enhance financial inclusion by promoting mobile payments and improving access to affordable housing finance; (d) increase access to finance for MSMEs and innovative enterprises by developing SME credit guarantee schemes, promoting microfinance development, and strengthening the legal and regulatory framework for private equity and venture capital investments; and (e) deepen the capital markets by strengthening the legal and regulatory framework and promoting development of the secondary market.
- **Axis 2 – Fiscal consolidation.** This axis focuses on: (a) improving public expenditure management on the basis of the new Budget Law; (b) strengthening revenue collection through reforms to the tax and customs administration; (c) restructuring the civil service and improving SOE governance and performance; (d) reforming the pension system; (e) reforming energy and commodity subsidies; (f) improving the public investment execution framework; and (g) reforming the legal framework for financing local development, including the decentralization of tax collection and promotion of local investment.
- **Axis 3 – Human capital development.** This axis focuses on: (a) reforming primary, secondary and higher education; (b) strengthening scientific and industrial research and

[6] Following the 2014 presidential and parliamentary elections, the Government developed a concept note, the *Note d'Orientation Stratégique*, for a 2016-2020 development plan. The *Note d'Orientation Stratégique* was organized around five strategic pillars: (a) good governance; (b) a dynamic "hub" economy; (c) human development and social inclusion; (d) regional development; and (e) green growth. The *Note* was followed by the Five-Year Development Plan, approved by Parliament on April 12, 2017.

development (R&D) at the national level; (c) improving vocational and on-the-job training programs; and (d) reforming labor market policies and regulations, including establishing of insurance for job loss and revisions to the Labor Code to allow for flexibility in the labor market.

- **Axis 4 – Redesign of the social security system.** This axis focuses on: (a) reforming the health care system, through a review of health care funding arrangements, health insurance reform, and the establishment of a health insurance system; (b) enhancing the sustainability of the pension system by reviewing its parameters, diversifying funding sources and improving governance; and (c) reforming the social assistance program by improving beneficiary targeting and expanding coverage to the most vulnerable.
- **Axis 5 – Business climate and private investment.** A set of wide-ranging reforms has been outlined to improve the investment climate and encourage private investment. These include actions to: (a) strengthen the legal framework of competition, including the adoption of a new Competition Law; (b) enhance the regulatory framework for public procurement, and improve efficiency and transparency of the public procurement system; (c) adopt a new Investment Code, and reduce the complexity and administrative burden of investment requirements; (d) strengthen the regulatory framework for PPPs; and (e) reform the legal framework for energy and natural resource management, including renewable energy resources.

36. **The Government has made gradual progress toward improving the business environment.** This includes the adoption of the Competition Law, the PPP Law, as well as the new Investment Code, which came into effect in April 2017. The Government has also made progress on establishing the Tunisian Investment Authority, which will act as a one-stop-shop to facilitate the procedures required for investors to create new companies and conduct business in Tunisia. In addition, several laws and decrees have been adopted to stimulate access to finance for MSMEs and promote digital entrepreneurship. These include a draft Credit Bureau Law; a draft code for Seed and Equity Capital to reduce the regulatory burden on investors; and the Start-up Act, which aims to enhance the regulatory framework for innovative high-growth SMEs and increase their access to early-stage equity finance. While some reforms in the energy and natural resource sectors have been launched (e.g., adoption of a legal framework for electricity generation through renewable energy in 2015), the challenge is to deepen reforms of energy subsidies and scale up and implement Tunisia's Renewables Plan, as outlined in the Council of Minister's recently approved decision (see section 4.2).

37. **Tunisia has also laid the foundation for social inclusion.** The 2013 Social Contract – adopted by the Government and the workers union and the private sector association (UGTT and UTICA) – addressed the crucial challenge of social inclusion. This included improving the targeting and coverage of the social safety net program. The Five-Year Development Plan also made inclusion a strategic priority and laid out a vision for building a national social protection floor that includes components targeting children, old age population, and extension of health insurance. In January 2018, the Government also announced an increase in cash benefits under the National Assistance Program to Families in Need (*Programme Nationale d'Aide aux Familles Nécessiteuses,* PNAFN); an increase in the minimum pension to mitigate living costs for retirees; and health insurance coverage for job seekers. Lastly, to promote inclusion of youth, the Government has made priority investments in the Active

Labor Market Programs (ALMP), but with mixed results due to design and implementation challenges. The Government is therefore keen on improving the ecosystem of the employment services to boost their performance and inclusiveness.

38. **The Economic and Social Roadmap 2018-2020, launched in 2017, aims to accelerate the reform momentum started under the Five-Year Plan and further boost entrepreneurship, competitiveness and economic growth.** The Roadmap is comprised of nine key initiatives: (a) removal of barriers to investment; (b) improvement of SME financing and the enabling environment for high-growth start-ups; (c) development of a national program to boost exports; (d) infrastructure investment through PPPs, to improve regional development and connect industrial zones and technological parks to highways; (e) implementation of a Digital Tunisia 2020 program; (f) implementation of the Tunisia Renewables Plan; (g) initiatives for improving the Rades port; (h) initiatives to manage tourism sector debt and the launch of new strategy to support the sector; and (i) harnessing PPPs for critical projects.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

39. **The proposed DPF is a stand-alone, single-tranche operation aimed at supporting the Government's effort to promote private investment and competitiveness, entrepreneurship, a more efficient and greener energy sector, and greater economic and social inclusion.** The operation is motivated by the need to: (a) shift to a growth model underpinned by private investment, trade and productivity; (b) support Government reform efforts to promote job creation and entrepreneurship, in the context of high youth and female unemployment and social pressures; and (c) strengthen the safety nets for vulnerable populations and promote greater productive economic inclusion. This operation also responds to a fragile macroeconomic context characterized by widening twin deficits, the deteriorating financial situation of the power utility, costly and distortive energy subsidies, and the need to improve the energy mix, which will attract potentially sizeable investments in renewable energy (solar and wind).

40. **The proposed operation supports key reform areas articulated in the Five-Year Development Plan 2016-20.** The operation is strongly linked to four of the five axes included in the Five-Year Plan and is also aligned with the Economic and Social Roadmap for 2018-2020. As such, the operation contributes directly to the Government's overall vision to place the private sector at the center of the growth and jobs agenda, create a level playing field for competition, deepen access to finance for young firms and entrepreneurs, and promote greater social inclusion and sustainable development. The operation also contributes to improving governance, transparency, and public service delivery.

41. **The design incorporates lessons learned from previous operations in four key areas:**

- ***The nature of the transition and related political economy considerations.*** Tunisia's transition continues to move forward but is incomplete and there are still signs of political instability. There have been multiple changes of Government and ministerial reshuffles, and peaks of social unrest and security threats. Considering this contextual dynamic, the international community has recognized the risk that overly sharp adjustment could destabilize (or even reverse) the gains achieved since the Revolution. Therefore, it has balanced the need, on the one hand, to deepen the adjustment and take the necessary urgent actions to tackle the deteriorating economic situation while, on the other hand, ensuring that such reforms are feasible and do not unnecessarily affect the fragile transition process.

- ***Matching the structure of the operation to the country context.*** The Bank has determined that a stand-alone operation with multi-sector coverage embedded in a larger dialogue around implementation is best suited to the current context of Tunisia. This structure allows the operation to focus on impactful reforms through complementary instruments, while lessening the risk of drift in timeliness and relevance that characterized past programmatic operations due to recurrent political and security shocks.

- ***Monitoring and follow-up of reforms at the highest level of Government***. The Bank has established a strong dialogue at the highest level of Government, allowing for strong follow-up of the reforms supported by the overall Bank engagement, while coordination remains with the Ministry of Development, Investment and International Cooperation (MDIIC).

- ***A focus on concrete and feasible actions to achieve results.*** In past DPF engagements in Tunisia, the implementation of necessary reforms was constrained. While progress on legislative reforms has been achieved over the past years, implementation has been uneven, with little impact on the economic environment. The proposed DPF builds on the legislative reforms by striking a balance between policy reforms and concrete implementation actions.

42. **The preparation of the proposed operation has involved intensive engagement to build a pro-reform coalition for the urgent actions needed to tackle the deteriorating economic situation.** It was difficult during the first years of the transition to move reforms forward when political capital was being conserved to deal with the constitutional and security crises and electoral milestones during 2013-15. During this period, however, the principle emerged of stakeholder consultations and consensus building around reforms, although this has required tempering optimistic assumptions about the pace of reform. Annex 7 outlines how the operation has addressed local political economy realities both at the level of this operation and at the level of the complementary World Bank portfolio in Tunisia.

43. **The DPF focuses on three policy areas:** (a) removing barriers to investment, trade and entrepreneurship; (b) moving towards a more efficient, sustainable and inclusive energy sector; and (c) promoting greater economic and social inclusion. The reforms build on previous DPFs and complementary advisory services and analytics (ASA), as well as catalyze upstream consensus around critical reform principles that future operations can support as they move toward implementation. Specific prior actions were developed during intensive dialogue between the Government and the Bank; the dialogue benefited from continuous

technical support to ensure that the prior actions adhere to quality standards and produce expected development outcomes in terms of economic and social opportunities.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

44. **The policy and results matrix as described in Annex 1 includes eleven (11) prior actions.** This section provides a detailed description of the reform agenda in the three policy areas and the specific prior actions supported by the proposed operation.

Pillar 1. Removing barriers to investment, trade and entrepreneurship

Prior action #1: To stimulate private investment and building on an exhaustive mapping of investment authorizations, the Borrower has approved a reduced list of economic activities that remain subject to authorizations, and defined the deadlines and procedures for processing authorization requests of economic activities under said reduced list, pursuant to Borrower's Governmental Decree No. 2018-417, dated May 11, 2018 and published in the Official Gazette No. 38 dated May 11, 2018.

45. ***Rationale:*** Regulations that hamper both foreign and local private investments remain in several sectors in Tunisia. According to a mapping exercise conducted by the MDIIC in 2017-2018, out of 600 economic activities, around 127 activities were found to be subject to investment entry authorizations (of which 48 differentiate between local and foreign investors), and another 144 activities are subject to administrative authorizations. While some authorizations relating to health, safety and environmental issues, or protecting consumers are legitimate, a large number can be removed or simplified, as they create room for discretion, limit competition, and restrict local and foreign investments. The subsectors with economic activities that are currently subject to authorizations account for more than 70 percent of GDP and 37 percent of the jobs.[7] The subsectors with the highest number of investment entry authorizations are commerce, transport, health, education, financial intermediation and auxiliary financial services.

46. Following adoption of the Investment Law (prior action of the 2017 Business Environment and Entrepreneurship DPF), MDIIC established a "Management by Objective unit" (UGO) to lead the work of streamlining investment entry authorizations. Under the Investment Law's implementing decree, the UGO had one year to complete the mapping of authorizations (April 2018 deadline) and two years thereafter to complete the simplification of authorizations (April 2020 deadline). The UGO has completed its mapping of authorizations and has gathered relevant information on the legal or regulatory basis for each authorization, along with procedures and documents required. The mapping exercise shows that most of the 127 investment entry authorizations are governed by laws, and only about 26 authorizations are governed by a decree.

[7] GDP and employment data as of 2016 and 2014, respectively. Granularity of the data varies significantly by subsector. Value-added data are available at 2-digit level for 45 percent of the activities, and at 3-digit level for the remainder, however, no data is available at 4-digit level to mirror the exact economic activities subject to authorizations..

47. ***Policy reform:*** Building on UGO's exhaustive mapping, and with the aim of sending a strong signal to investors that investment-entry requirements are made easier and more transparent, the Government has issued a decree on May 11, 2018 that introduces a reduced list of 100 investment entry authorizations that will be maintained. Therefore, the decree enacts a first wave of simplification consisting of 27 authorizations to be eliminated or simplified through specifications (or "*cahiers de charge*")[8]. The elimination or simplification of these authorizations will take effect within a maximum period of six months from the date of publication of the decree to allow concerned ministries and agencies to produce relevant specifications ("*cahiers de charge*") for activities where compliance with relevant standards (technical, environmental etc.) remains necessary. Economic activities relating to the 27 authorizations span across different sectors such as agriculture (seeds production and marketing, fish farming/aquaculture), ICT (establishment of mobile virtual network operators, provision of internet services), and hotel and tourism services (hotel management, tourism leisure and entertainment services). The related subsectors account for more than 44 percent of GDP and 10 percent of the jobs (World Bank estimates)[9].

48. The decree also defines, for the 100 economic activities that remain subject to investment entry authorizations, the deadlines and procedures for processing authorization requests thereby operationalizing the principle of "silence means consent" introduced by the Investment Law. The "silence means consent" principle establishes that if a decision (acceptance/refusal) regarding a request for authorization is not issued by the relevant ministry or agency within the legally mandated timeframe, then the decision is deemed positive and the authorization is granted[10]. In addition, any refusal must be justified in writing by the relevant public body.

49. ***Expected results:*** This first wave of simplification - consisting of 27 authorizations to be eliminated or simplified together with the reduced list of authorizations to be maintained along with procedures and deadlines for decisions on related authorizations requests- represents an important signal for investors. It will be complemented by subsequent rounds of simplifications covering further economic sectors by April 2020, which is critical to cover important additional sectors such as higher education, health, ICT and transport. The simplification measures will help create an environment that is more transparent and encourage local and foreign investment which are expected to increase in the medium and long term. The reform will also help reduce market distortions and improve competition. It is expected that this reform will help encourage greater private sector participation in the economy. The proposed result indicator for this prior action is the number of investment

[8] Of the 27 authorizations to be eliminated or simplified, 12 are governed by decrees and 15 by laws. Elimination or simplification of authorizations through a Governmental decree is stipulated in the Investment Law, Article 4 which reads: "The list of economic activities subject to investment entry authorizations, the list of administrative authorizations and the deadlines, procedures and conditions for their issuance shall be defined by Governmental decree."

[9] See footnote 8 above.

[10] The decree specifies a 60-day deadline for authorizations to be delivered by a single ministry or agency; a 90-day deadline for authorizations involving multiple ministries or agencies; and a 180-day deadline for authorizations involving the Higher Council for Investments. In the case of silence, the authorization decision is deferred to the Tunisia Investment Authority (TIA) which has 15 days to issue the decision. The Central Bank of Tunisia and the Financial Markets Council are exempt from the application of the "silence means consent" principle.

authorizations eliminated and simplified (through specifications), with the 2019 target of 10 eliminated and 17 simplified.

50. ***Implementation support and complementarities with other IFIs:*** After the first wave of simplification linked to this DPF, and in accordance with the timeframe specified in the Investment Law, the Government intends to conduct additional waves of simplification until 2020. The Government will require support in the development of specifications ("cahiers des charges") for the authorizations that are to be simplified. The IFC and the World Bank (FCI Advisory Unit) will continue providing technical assistance for the simplification effort over the coming 18-24 months and will continue to coordinate with the OECD and other IFIs that have shown interest in supporting the Government in this ambitious reform. Implementation risks remain high,. and progress on timely issue of satisfactory specifications will be monitored closely during supervision of the proposed operation.

Prior action #2: To reduce the time and cost to export and improve the transparency of trade procedures, the Borrower has made mandatory the digitization of all export and import procedures and the connection of all institutional stakeholders involved in trade to the Tunisia Trade Net platform by the end of 2018, pursuant to Borrower's Conseil Supérieur des Exportations Decision dated January 4, 2018.

51. ***Rationale:*** Tunisia's trade deficit has widened sharply since the Revolution and international reserves have dwindled. Export growth has been moderate despite sizeable real exchange rate depreciation due to high import content in several sectors, supply bottlenecks and significant transport and logistics bottlenecks. The Government is conscious of the challenge and the need for measures to expand exports further and reduce import cost through concrete and visible improvements in trade facilitation.

52. Currently, cargo dwell time hovers around 12-15 days[11] year-round. In addition, the time to release containers from the main Port of Rades, remains high, adding cost to the private sector and exporters. There are multiple reasons behind these delays. From the import side, it takes a long time to unload vessels due to poorly maintained equipment in the Port of Rades, multiple breakdowns and limited repair capacity, work stoppages due to strikes, limited container storage space and use of the port for storage by importers due to low penalties on such practices, and complex procedures that further delay the processing of paperwork. On the export side, long dwell time generates uncertainty for exporters, who consequently bring their containers to the port ahead of cargo loading and shipping.

53. Both importers and exporters suffer from lengthy procedures that have not been digitalized and connected to the Tunisia Trade Net platform (TTN). As of May 2018, the authorities have identified the procedures that would need to be dematerialized and connected to TTN to make the import and export processes smoother and reduce bottlenecks. These procedures are issued and managed by different stakeholders, including the Ministry of Commerce and Customs (*Societe Tunisienne d'Acconage et de Manutention,* STAM), the

[11] Professional estimates indicate that idle time costs each shipper about US$1.2 million per day. With an average of 15 cargo ships idle in the Port of Rades, the total cost per year can reach US$600-$700 million, or 1.6 percent of Tunisia's GDP. See http://kapitalis.com/tunisie/2017/12/20/un-expert-evalue-a-16-du-pib-le-cout-des-staries-au-port-de-rades.

Office of the Merchant Marine and Ports (*Office de la Marine Marchande et des Ports*, OMPP) and sector ministries.

54. ***Policy reform:*** In December 2017, the Government established the High Council for Exports (*Conseil Supérieur des Exportations, CSE*) to prioritize and improve the impact of its export-promoting reforms. In January 2018, the CSE adopted 20 measures to promote exports, including the mandatory digitalization of all trade-related procedures and the connection of all stakeholders to the Tunisia Trade Net platform by the end of 2018. Implementation monitoring reports are presented at the CSE meetings held every six months; the next meetings will be in July 2018 and January 2019. Given the expected impact of the following procedures on exporters and importers, their digitalization receives special attention in the proposed operation:

- The *Foreign Trade Certificate (Titre de Commerce Exterieur),* issued by the Ministry of Commerce, which is a requirement for foreign currency payments. The certificate will be transmitted electronically to the Central Bank to reduce the time and improve the traceability of foreign currency payments for import and export transactions. Current manual processes are inefficient and suffer from system delays and breakdowns.

- The *Merchandise Loading Certificate (Visa d'Embarquement),* issued by Customs to certify that expected exports actually materialize. This certificate allows exporters to benefit from import tax exemptions and recover the financial guarantees required for imports that are used as inputs for exports. These guarantees are large: 5 percent of export value if there has been value addition on imports (*regime suspensif actif*) and 100 percent of taxes on other imports (*regime suspensif passif*). Currently, Customs can take several months to a year to issue this certificate. Digitization would make issuance of the certificate immediate and help all exporting firms, in particular SMEs that are financially constrained, to improve their financial situation. This certificate will be transmitted electronically and signed by Customs electronically.

- The *Notice of Arrival of Imported Merchandise* (*Avis d'Arrivée de Marchandises*), needed to alert importers of merchandise arrivals at port. This notice includes the detailed requirements for initiating the customs clearance process and paying import duties. It also notifies importers that Customs and port authorities will apply penalties on containers that are not removed within a specified period of time. The Notice of Arrival will be added into the Tunisia Trade Net platform electronically to help reduce delays in processing arriving containers and the resulting congestion at the Port of Rades.

55. ***Expected results:*** The digitization of export and import procedures will translate into important gains for the private sector in terms of time, cost and transparency. Faster processes will also help move the import containers more swiftly out of the ports, saving money for the importers and reducing port congestion. The proposed results indicators for the operation are: (a) dematerialization of the Foreign Trade Certificate, the Merchandise Loading Certificate and the Notice of Arrival of Imported Merchandise; and (b) reduction of the number of days required for issuance of the Foreign Trade Certificate (from 7 days in 2017 to 3 days in 2019).

56. ***Implementation support and complementarities with other IFIs****:* Several ongoing initiatives will help reduce port congestion and dwell time for vessels, including: (a) new equipment and software acquisitions to optimize container storage management (under the ongoing World Bank-financed Third Export Development Project); and (b) a new mandatory requirement for all importers to enter the prior notice of shipments (*preavis*), to allow Customs and port authorities to address notifications and apply penalties to those importers and their representatives who do not remove their containers. The need for faster procedures is also essential to translate gains in dwell time into effective gains for exporters. The implementing agency, Tunisia Trade Net, has identified the list of procedures to be digitalized, by stakeholder and readiness level. The next steps consist in setting a timetable and rolling out the plan for digitization of each measure, in consultation with the responsible agencies. This reform also expands the scope and accelerates the implementation of trade facilitation reforms supported by the 2017 Business Environment and Entrepreneurship DPF.

Prior action #3: To improve SMEs access to markets, the Borrower has made e-procurement (through TUNEPS) mandatory for public procurement pursuant to the Borrower's Governmental Decree No. 2018-416 dated May 11, 2018, published in the Official Gazette No. 38, dated May 11, 2018, modifying and complementing Decree No. 2014-1039 dated March 13, 2014 regulating public procurement.

57. ***Rationale:*** Public procurement in Tunisia experiences chronic delays at various stages in the process, as well as low participation by SME suppliers and contractors. The negative effects of these shortcomings include diminished value for money in public spending and failure to harness the potential of public procurement to promote economic development and job creation.

58. Government decree No. 2014-1039 dated March 13, 2014 mandated that 20 percent of public contracts are to be awarded to SMEs. The decree also introduced the online tool, TUNEPS, which allows firms to access annual procurement plans, and offers investors the possibility of procuring goods and services using an e-shopping mall and e-catalogs. TUNEPS eases access to procurement opportunities by SME suppliers and contractors in lagging regions. However, the 2014 decree did not direct public entities to use TUNEPS (Article 55) and many continued to use paper-based methods, resulting in SMEs lacking information about contracting opportunities. This lack of information, compounded by general business environment constraints, limited access to finance and capacity constraints have resulted in contract awards to SMEs that are well below the mandated 20 percent.

59. ***Policy reform****:* The prior action consists of approval by the Council of Ministers and publication of a decree making mandatory the use of TUNEPS by line ministries, SOEs and parastatals (starting September 2018) and local governments (starting September 2019). This decree will be pivotal in actualizing the potential of TUNEPS to improve budget execution and implementation of the Government investment program. It will also increase access to public contracting for SMEs, including those in lagging regions, and will improve transparency, integrity and accountability of the procurement process.

60. ***Expected results****:* The reform is expected to: (a) increase the participation of suppliers and contractors, including SMEs, in public procurement proceedings, thus enabling greater

competition, invigorating private sector activity and increasing job opportunities; (b) increase the participation of firms in lagging regions through use of the online tool; (c) help ensure transparency, security and equal treatment for all bidders; and (d) improve efficiency of public procurement through reduced transaction costs and speed. By broadening access to the public procurement system, the reform will enable firms with lower access, particularly SMEs in lagging regions, to gain access to new markets and thus create new opportunities for job creation. The results indicators for the proposed operation are: (a) a share of ministries, SOEs and parastatals conducting their procurement through TUNEPS, expected to increase from a baseline of 84, 45 and 34 percent, respectively, in 2017 to 100, 60, and 50 percent by the end of 2019. Since implementation by local governments will only start in September 2019, indicators for local governments are not included in the results framework; and (b) a share of public contracts awarded to SMEs. The baseline for the second indicator comes from a non-random sample of 32 public entities in a study conducted by National Public Procurement Observatory (ONMP) in 2017, which indicated that 17 percent of their procurements was awarded to SMEs.[12] The target, as mandated by the Governmental decree No. 2014-1039 of 13 March 2014, is a 20 percent share of public contracts awarded to SMEs.

61. ***Implementation support and complementarities with other IFIs****:* To support the reform implementation, the Bank will assist in strengthening the capacity of the Tunisian Public Procurement Authority (*Haute Instance de la Commande Publique,* HAICOP) to manage the e-procurement platform. Other partners supporting the reform include AfDB through the MENA Transition Fund, which will support TUNEPS maintenance and implementation of an e-archiving platform; and EBRD, which will assist HAICOP, through the United Nations Commission for International Trade Law (UNCITRAL) Initiative, in expanding the adoption TUNEPS. This reform is an important complement to the business environment reforms supported by several donors to stimulate SME growth and entrepreneurship.

Prior action #4: To improve SMEs access to finance, the Borrower's Council of Ministers has approved and transmitted to Parliament the draft Law on Secured Transactions aligned with the UNCITRAL Legislative Guide on Secured Transactions, pursuant to Borrower's Council of Ministers' decision dated May 7, 2018 and Transmittal Letter to the Parliament dated May 16, 2018.

62. ***Rationale:*** Lack of collateral often hampers access to bank credit for SMEs, especially those run by women, youth, and less-connected entrepreneurs. Banks prefer immovable collateral such as land and buildings to secure their loans, while SMEs own mostly movable collateral (e.g., inventory, receivables). Tunisia's framework for movable collateral is fragmented, uncertain and costly to use, further impeding SMEs' access to much-needed finance. In the 2014 World Bank Enterprise Survey, Tunisian firms ranked access to finance as their third biggest obstacle. A greater percentage of firms with female top managers (36.4 percent) reported access to finance as a major constraint compared to firms with male top

[12] 17 percent baseline is likely overestimated given that the public entities that responded to the survey would tend to be the ones complying with the provisions of the decree.

managers (22.8 percent).[13] In addition, female entrepreneurs tend to be "fixed asset poor"[14] and tend to hold wealth in movable assets that cannot be easily leveraged as collateral for loans.[15] A modern secured transaction framework will contribute to addressing this constraint and closing the gender gap in access to finance by allowing banks to use movable collateral more cheaply and with more certainty as loan security. Such framework also supports: (a) working capital financing, by providing the legal and institutional basis for value chain participants (producers, wholesalers, distributors) to pledge movable collateral for suppliers' credit; (b) bank lending to SMEs contracting with the public sector, by pledging their receivables from public entities; and (c) substituting some government financing of state-owned enterprises by bank financing secured by receivables.

63. ***Policy reform:*** The draft Law approved by the Council of Ministers and transmitted to Parliament on May 16, 2018 establishes the legal and institutional framework for secured transactions, based on best international practices and adapted to Tunisia. It simplifies the legal processes governing the pledging of movable assets as security for loans, and provides for the conditions under which, after default, lenders may repossess the assets. Through the creation of a single e-registry for movable collateral, the Law will harmonize procedures for the creation of security rights, facilitate their realization and ensure the financiers have real-time information concerning these rights.

64. ***Expected results:*** The new secured transactions framework will contribute to strengthening the rights of creditors in movable collateral and will enable the creation of a movable assets registry. The implementation of this reform will substantially expand the types of assets firms can use as collateral. This will alleviate collateral constraints and level the playing field in terms of access to credit, particularly for SMEs, including those managed by women and youth. In countries where effective secured lending regimes have been established, borrowers with collateral get nine times the level of credit relative to their cash flow compared to borrowers without collateral. They also benefit from longer repayment periods (11 times longer) and significantly lower interest rates (50 percent lower).[16] The enactment of the new Law is also expected to improve Tunisia's Doing Business ranking.[17] The results indicator for the proposed operation is the establishment and operationalization of the electronic registry for movable collateral by end-2019.

65. ***Implementation support and complementarities with IFIs:*** The draft Law was prepared by the Ministry of Justice with the support of the Word Bank, IFC and USAID. The World Bank and IFC will support the authorities in drafting the implementing regulations and developing and operationalizing a centralized electronic movable collateral registry. The

---

[13] World Bank (2013). Tunisia Enterprise Survey. Available:
http://www.enterprisesurveys.org/data/exploreeconomies/2013/tunisia

[14] ILO (2016) Women Entrepreneurship Development Assessment Report. Available:
http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_551170.pdf

15 IFC (2010). Secured Transactions Systems And Collateral Registries. Available at:
https://www.ifc.org/wps/wcm/connect/c5be2a0049586021a20ab719583b6d16/SecuredTransactionsSystems.pdf?MOD=AJPERES.

[16] "Increasing Access to Credit through Reforming Secured Transactions in the MENA Region." De La Campa, 2011.

[17] The new Law on Secured Transactions would be reflected under the "Getting Credit" Doing Business indicator's "Strength of Legal Rights Index," which measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending.

World Bank Group (WBG) will also support building the capacity of local public and private stakeholders, especially the banking sector and non-banking financial institutions, on the applications of the Law and the registry system. Highest level commitment to improve Tunisia's Doing Business ranking is expected to instill momentum for final approval of the Law, the issuance of implementing regulations, establishment of the registry.

Prior Action #5: To improve SMEs access to finance, the Borrower has improved the financial products offered by the SME Credit Guarantee Fund, its operating and payment procedures and its risk management framework, pursuant to an agreement (Convention) between the Borrower's Ministry of Finance and the Société Tunisienne de Garantie dated April 18, 2018.

66. ***Rationale:*** The SME Credit Guarantee Fund (FGPME, *Fonds de Garantie des Petites et Moyennes Entreprises*), which provides partial guarantees to banks that lend to SMEs and is managed by SOTUGAR[18] (*Société Tunisienne de Garantie*), is a key component of the Government's policy aiming at alleviating the SME finance constraint. In 2017, it had a capitalization of TND 101 million and a guaranteed portfolio of TND 588 million.[19] Partial credit guarantee schemes have been identified as one of the most market-friendly types of interventions in support of SME access to finance, as they generate fewer distortions in the credit market compared to other interventions such as direct state lending to SMEs or subsidized refinancing of bank loans to SMEs. They also maximize public financial resources by leveraging private financial sector resources[20] and by charging fees to lenders against loan guarantees.[21] Through the provision of risk mitigation tools, partial credit guarantees provide a strong incentive for banks to get into the SME market, while retaining sound incentives for loan origination and oversight, thereby improving SMEs' access to finance.

67. During the 2014-2016 period, the FGPME fell well short of expectations. Its guarantee production decreased by 30 percent. The fund has also failed to attract significant private financing for SMEs, with mainly public banks using the scheme to transfer off-balance sheet portions of non-performing loans. These failures can be attributed to narrow loan eligibility criteria (limits on working capital loans and ineligibility of loans in economic sectors beyond industry) and a high administrative burden to obtain payment of guarantees. Further, the fund has no lender screening or ex ante risk management framework.

68. ***Policy reform:*** The measure corrects deficiencies of FGPME by:

a) *broadening the guarantee eligibility criteria to cover the full spectrum of SME credit needs*, through inclusion of more eligible economic sectors and working capital loans;

---

[18] The SOTUGAR is a joint-stock company established in 2002 under the Tunisian common law with the capital of TND 3 million, of which main shareholders are the State of Tunisia (37 percent) and the main banks (63 percent). SOTUGAR manages nine loan guarantee funds, among which the FGPME (SME fund) which accounts for 44 percent of the institution's commitments.

[19] Guaranteed portfolio includes SME loans by banks and leasing companies (74 percent) and equity investments in SMEs by private equity funds (26 percent). Source: SOTUGAR.

[20] in line with the Maximizing Finance for Development approach.

[21] In the case of FGPME, the guarantee fees and financial proceeds from invested capital cover payments on guarantees to lenders.

b) *strengthening the financial sustainability of the fund and management of related fiscal risk,* through: (i) the introduction of a stop-loss mechanism that caps losses to FGPME; (ii) due diligence on banks that want to use FGPME; and (iii) auditing of banks' practices concerning underwriting and recovery of NPLs. SOTUGAR's risk management function would also be strengthened;

c) *reviewing operating and payment procedures to attract more private banks into the system,* through: (i) the introduction of a portfolio guarantee mechanism for smaller loans, and (ii) payment of guarantees as soon as banks initiate legal proceedings.

69. ***Expected results:*** The reform of the FGPME will contribute to improving SMEs' access to finance by attracting more lenders to use the guarantee fund, while excluding the banks that generate high levels of NPLs. The reform will also strengthen the Government ability to manage fiscal risks of the guarantee scheme. The results indicator for the proposed operation is the increase in volume of SME loans guaranteed by SOTUGAR,[22] from TND 437 million in 2017 to TND 500 million by the end of 2019.

70. ***Implementation support and complementarities with IFIs:*** The new agreement between the Ministry of Finance and SOTUGAR has been prepared with World Bank technical assistance. Wide industry consultations were undertaken to prepare the reform. World Bank and KfW technical assistance and capacity building will support implementation of the reform by SOTUGAR and participating lenders.

Pillar 2. Moving towards a more efficient, sustainable and inclusive energy sector

Prior action #6: To contain the electricity and gas subsidies, the Borrower has approved an electricity and gas tariff adjustment in line with its Energy Subsidy Reduction Policy Note, pursuant to the Borrower's Minister of Energy, Mines and Renewable Energy's Letter addressed to STEG dated May 10, 2018.

71. ***Rationale:*** Tunisia's energy sector is facing the critical challenge of national production trailing the rapidly growing demand for energy, which is driven in part by subsidies. The demand for oil and its refined products increased by 6 percent in 2017, especially gasoline (11 percent), electricity (10 percent), diesel (7 percent), and natural gas (5 percent). Rising levels of domestic consumption, driven in part by energy subsidies, accounted for 7.2 percent of Tunisia's GDP in 2013.[23] Since then, subsidies have decreased, mainly due to lower international oil and gas prices. The World Bank estimates that post-tax subsidies for 2017 are around 2.6 percent of GDP.[24] The widening gap between domestic supply and demand, however, will continue to put pressure on public finances. There is also a real risk that international oil prices will continue to rise, which would cause the subsidy to increase if

[22] Source: SOTUGAR annual reports.
[23] The subsidy estimate uses the price-gap methodology, which defines energy subsidies as the difference between the domestic market price and the total cost of supply, including production, transport, and distribution costs and taxes, multiplied by domestic consumption. The production cost is based on the price of Brent.
[24] The post-tax subsidies include the foregone tax revenue, since VAT is applied to the subsidized price rather than the actual cost. It is not the same as the subsidy expenditure (1.2 percent of GDP in 2017), as the subsidy payment does not cover the full gap between the consumer price and the cost of supply.

no measures are taken to reform energy pricing, regulate prices of energy products, and improve sector performance to reduce cost.

72. In addition to being fiscally unsustainable, subsidies are also regressive. They are mostly allocated to electricity (34 percent), LPG (25 percent), diesel (19 percent) and natural gas (12 percent), according to World Bank estimates. Aside from LPG, which is mostly consumed by the poor, the majority of subsidies for other energy products benefit middle and high-income customers, who tend to consume more energy. For natural gas and electricity, 60 and 50 percent of subsidies, respectively, benefit industrial and commercial customers. Among households, 58, 60 and 70 percent of subsidies for diesel, natural gas, and gasoline go to the richest quintile, while less than 5 percent goes to the poorest.

73. ***Policy reform:*** In an effort to contain and eliminate subsidies, the Government eliminated price controls on oil and gas inputs for refining and power generation in 2015. STIR and STEG now buy input fuels at international prices, thereby eliminating implicit subsidies. The difference between their costs and the tariffs are compensated through annual budget allocations. In January 2016, the Minister of Energy, Mines and Renewable Energy **(**MEMER) and the Ministry of Finance introduced a commission responsible for determining the prices of gasoline and diesel every quarter with a cap of 5 percent for each price adjustment (prior action of the IMF EFF program). However, implementation of the fuel adjustment mechanism has been uneven, with only two adjustments validated by the Government, and these adjustments were lower than what the adjustment mechanism would have suggested.

74. The Government's Energy Subsidy Reduction Policy Note adopted in May 2018 outlines its plan to eliminate subsidies and lay the foundation for price adjustments to be implemented in a systematic manner. In the short term, price adjustments will be gradual and will focus on fuels that are consumed less by the poor and more by wealthier households and large corporate users, such as gasoline, diesel, electricity and natural gas. This approach is also motivated by Government efforts to stimulate energy efficiency improvements and will be accompanied by Government programs to support adoption of energy efficiency measures among consumers, both households (e.g., access to photovoltaics and high-efficiency appliances) and firms (e.g., facilitation of co-generation). Also in the short term, the reform will focus on: (a) devising a framework for transparent and rules-based pricing; (b) identifying actions to reduce STEG's losses and improve its performance (see prior action #7); (c) preparing the social safety nets to protect the poor and vulnerable from price shocks; and (d) developing a communication plan to inform the public about the rationale for subsidy reform and accompanying measures. In the medium term, with more public acceptance and a stronger safety nets system, the subsidy reform will be accelerated and applied to all energy products.

75. ***Expected results:*** Successful implementation of subsidy reform will help the sector move to full cost recovery, contain the deficit and free up fiscal space for more inclusive growth and welfare-enhancing expenditures. The careful handling of tariff adjustments, through proactive communication and parallel social protection measures, will contribute to securing public acceptance. Better targeting of Government subsidies will also advance the social inclusion agenda. In the absence of tariff reform, the subsidy bill of 2018 could exceed 3 percent of GDP at current oil and gas price projections (World Bank estimates) and could increase further if those prices rise or the exchange rate depreciates.

76. The electricity and gas tariff adjustments enacted by the Government, detailed below, will generate fiscal savings estimated at TND 213 million, or 0.2 percent of GDP in 2018 (World Bank estimates):

- Electricity:
    - High and medium voltage: +7% effective May 1, 2018 and +7% effective September 1, 2018;
    - Low voltage: +7% effective July 1, 2018;
- Gas
    - High and medium pressure: +10% effective May 1, 2018 and +7% effective September 1, 2018;
    - Low pressure: +10% effective July 1, 2018.

77. Continued implementation of tariff adjustments, as laid out in the Government's Policy Note, will generate further savings of TND 777 million, or 0.7 percent of GDP in 2019 at current projections of oil prices and exchange rate (World Bank estimates). The adjustments will also increase the cost recovery of electricity and gas from 73 and 60 percent (baseline) to 86 and 72 percent, respectively (World Bank projections). Without tariff increases, electricity and gas subsidies would rise to at least 1.6 percent of GDP in 2019 due to higher international oil and gas prices and potential exchange rate adjustments. The results indicator for the proposed action is the reduction of electricity and gas subsidies from 1.2 percent of GDP in 2017 to 1 percent of GDP in 2019.

78. ***Climate co-benefits:*** That said and in light of climate change threats, the proposed prior action is expected to contribute to climate change adaptation through the optimization of energy consumption. This measure is on the list of eligible mitigation activities set by the multilateral development banks (MDB), under Category 9.1, "Efficient pricing of fuels and electricity (efficient end-user tariff)."

79. ***Implementation support and complementarities with other IFIs:*** Energy subsidy reform is a key component of the IMF EFF program, which includes a rolling prior action on quarterly application of the fuel price adjustment mechanism in line with the Budget Law, to reduce the fiscal deficit and shield the budget from oil price increases. The World Bank will provide support to the Government's sector reform agenda, including accompanying measures, through an Energy Sector Management Program (ESMAP)-funded technical assistance and an ongoing MENA Transition Fund project on social protection reform.

Prior action #7: To improve the performance of the STEG through actionable performance contracts, and greater accountability, the Executive Board of STEG and the Borrower's Minister of Energy, Mines and Renewable Energy have approved a commercial action plan for STEG to reduce losses and improve collection of bills in line with the objectives of STEG's performance contract for 2016-2020, pursuant to Borrower's Minister of Energy, Mines and Renewable Energy's Letter dated April 18, 2018.

80. ***Rationale****:* Tunisia's electricity and gas market is based on a single buyer system, with the public utility, STEG, at its center. As a vertically integrated utility, STEG is responsible for the key electricity service functions, including generation, systems operation, transmission and distribution, as well as transmission and distribution of natural gas. STEG is faced with significant financial challenges due to low (highly subsidized) energy tariffs, deteriorating technical and commercial performance, increased losses and a low collection rate, which has dropped to 76 percent in 2016 from more than 84 percent in 2015. Total energy losses in the electricity network reached 16.4 percent in 2016.[25] STEG has suffered from negative net profit since 2010; net losses in 2016 were TND 354 million or 9 percent of revenues (including state subsidies) and rose to TND 780 million or 16 percent of revenues in 2017. In addition to its own budget, STEG mobilizes loans from international donors, with sovereign guarantees from the state, to finance its investment program, but their execution rate for the period remains low, barely reaching 10 percent at the end of 2016.

81. To address this situation, STEG signed a performance contract with the Government for the 2016-2020 period, in which it committed to improve its technical, commercial and financial performance, and more importantly, to sustain those achievements over time given the Government's plans to increase electricity tariffs to the level of cost recovery. The contract introduces ten performance indicators along the areas of expansion of generation, transmission and distribution, strengthening the connection to the natural gas network, reduction of technical and commercial losses, implementation of energy efficiency measures, and recovery of unpaid bills from public and private customers.

82. ***Policy reform:*** STEG and MEMER have identified and approved specific actions to increase electricity bill collection and reduce technical and non-technical losses (unmetered consumption). The commercial performance action plan includes installation of smart meters for all large consumers, strengthening of anti-fraud teams, verification of meter readings for large consumers, and establishing incentive measures for fraud detection in order to reduce commercial losses. The commercial action plan also introduces measures to improve the efficiency of billing through automation of meter reading combined with more regular and reliable metering. To reduce non-payment among private customers, the plan outlines actions to improve the efficiency of billing and payments (bill distribution through the post office and other methods such as email and SMS, pay stations and mobile payments). The plan also sets complementary actions such as better multi-level controls, more resources for the local collection offices, training staff on better collection methods, and systematic telephone reminders. The efficiency of these procedures will require an upgraded commercial IT system, which will be procured in 2019.

83. ***Expected results:*** The improvement of STEG's commercial performance will strengthen its financial viability and enhance its credibility as a buyer of electricity generated by private sector energy projects, including renewable energy projects. It will also reduce the need for guarantees for imports from Europe. Actions to protect STEG revenues will be an important accompaniment to the subsidy reform, as experience in middle-income countries has shown that an increase in electricity tariffs typically results in a rise in nonpayment or fraud. Furthermore, the improvement of billing and collection efficiency can help reduce the

[25] Source: STEG annual report.

cost of service, hence relieving pressure on subsidies. The results indicators for the proposed prior action are: (i) a reduction of total transmission and distribution losses from 16.4 percent of generated power in 2016 to 12.5 percent in 2019; and (ii) an increase in collections of electricity and gas bills from 76 percent 2016 to 82 percent in 2019.

84. ***Climate co-benefits:*** The commercial performance action plan includes several measures to reduce technical losses, including reinforcing distribution grids, installing capacitator banks and autoregulators, and managing energy use among large consumers. The proposed prior action is aligned with the MDB list of eligible mitigation measures under Category 3.3 "Improvement in utility-scale energy efficiency through efficient energy use and loss reduction."

85. ***Implementation support and complementarities with other IFIs:*** The World Bank will provide technical assistance to implement the commercial strategy as part of the same ESMAP-funded TA. Addressing the commercial losses of STEG will reduce costs and facilitate the subsidy reform agenda. The proposed prior action also complements the IMF EFF program, which includes the adoption of performance contracts of four large public enterprises, including STEG.

Prior action #8: To improve the energy mix, the Borrower has adopted a decision to scale up and accelerate the implementation of Tunisia's Renewables Plan through private sector owned renewable energy capacity, pursuant to Borrower's Council of Ministers' Decision dated February 28, 2018.

86. ***Rationale:*** The growing gap between production and demand underlines the need for improving energy security and diversifying the energy mix by, among other things, increasing the share of renewable energy. Electricity production in Tunisia has become increasingly gas based, and all gas imports are from neighboring Algeria, which makes Tunisia vulnerable to international gas price fluctuations, widens the trade deficit, increases the need for Central Bank foreign exchange interventions and lowers reserves. Currently, the generation mix is about 77 percent based on open and combined-cycle gas turbines, 20 percent on dual fuel steam units (natural gas and heavy fuel oil) and 3 percent on renewable energies.[26] Projections show that, under all demand growth scenarios, Tunisia will need to increase its imports of gas. Although there are opportunities for developing new domestic gas fields, those reserves are limited and uncertain. Increasing the share of renewables in the electricity generation will also help reduce cost, as solar and wind generation have become very competitive in recent years and attract foreign investment and technology.

87. ***Policy reform:*** The Tunisian Renewables Plan (TRP) aims at integrating 30 percent of total electricity generation from renewable energy (RE) sources by 2030. The TRP will be implemented in two phases, with 1 GW installed by 2020 and an additional 1.25 GW during the 2021-2025 period, with significant technical assistance from GIZ. The TRP proposes that two-thirds of the renewable energy capacity be developed through private sector projects and

[26] World Bank. 2014. *A strategic vision for the Tunisian energy sector: reflecting on priority issues: Une vision stratégique pour le secteur Tunisien de l'énergie: réflexion sur des thèmes prioritaires (French)*. MENA Energy Series. Washington, DC: World Bank Group.

the rest by STEG. To support the development and implementation of the TRP, the Government has adopted several regulations. Most notably, the Renewable Energy Law No. 2015-12, promulgated in 2015, sets out the legislative framework for the promotion of RE. This Law was later supplemented by the decree No. 2016-1123, which provides modalities for the realization of RE projects. Private power projects will be developed under three schemes: concessions for large-size projects, authorization for small and medium-size projects, and auto-generation for industrial users. In May 2017, the first phase of the TRP was officially launched through a call for projects to develop 210 MW of electricity generation capacity from wind and solar under the authorization scheme.

88. On February 28, 2018, the Council of Ministers adopted an action plan to scale up and accelerate the implementation of the TRP, particularly for projects under the concession scheme. The target was raised from 200 MW to 600 MW capacity by 2020, thus raising the overall target of the Program from 1,000 MW to 1,400 MW. The MEMER has mobilized international transaction advisors to ensure the attractiveness of the concession scheme to international investors and financial institutions. The action plan also includes specific measures to improve the regulatory and institutional framework for the TRP, such as improving the power purchase agreement, simplifying procedures for attributing project under the authorization scheme, and revising the tariff and simplifying procedures for approving projects under the auto-generation scheme. On May 11, 2018, the MEMER issued the call for pre-qualification of investors under the concession scheme for up to 500 MW solar and 500 MW wind, which marks an important milestone in materializing the Government's commitment to accelerating and scaling up the TRP.

89. ***Expected results:*** The reform will help improve Tunisia's energy mix and energy security (particularly for peak demand in the summer, when solar power generation will also be at its peak), boost private investment and reduce the cost of power generation. It will thereby lower Tunisia's dependence on gas and oil products, which in the medium term will help contain energy imports, a major source of Central Bank interventions in the forex market in the context of high current account deficit and dwindling reserves. The results indicator for the proposed actions is the selection, under the concession scheme, of private sector-owned projects totaling at least 300 MW by end-2019. The results indicator focuses on solar capacity mobilized in view of the timing of the proposed operation and due to the specificity of the wind concession, which may take more time. Based on international experience, the solar concession scheme is expected to attract foreign investment of up to US$300 million in 2020-2022, which would be equivalent to 38 percent of FDI inflows in the energy sector in 2016.

90. ***Climate co-benefits:*** By encouraging private investment in renewable energy, the proposed prior action is expected to contribute to shifting energy production toward low-carbon technologies and reduce greenhouse gas (GHG) emissions, and is considered part of the MDB list of eligible mitigation activities under Category 9.1, "National policies/plans for scaling up renewable energy."

91. ***Implementation support and complementarities with other IFIs:*** This policy reform is also supported by GIZ through a large technical assistance program with the MEMER. IFC and EBRD are also providing technical assistance and advice on structuring the renewables program for private sector investment. The reform measure is in line with the objective of

reducing energy subsidies, as renewable energy will help lower the cost of energy generation and supply and attract FDI. This will have macroeconomic significance and will support the implementation of the IMF EFF program.

Pillar 3. Promoting greater economic and social inclusion

Prior action #9: To establish the foundation for a well targeted and fiscally sound expansion of the coverage of social safety nets, the Borrower's Council of Ministers: (i) has approved and transmitted to Parliament the Social Protection Draft Organic Law (Loi Organique Amen Social) which, in particular, establishes the principle of targeting of safety net programs; and (ii) has approved the new targeting model, including key implementation procedures, all pursuant to Borrower's (i) Council of Ministers' Decision dated September 13, 2017 and transmittal letter to Parliament dated December 26, 2017, and (ii) Council of Ministers' Decision dated May 7, 2018, respectively.

92. ***Rationale:*** Tunisia needs to modernize the legal framework and improve its approach to targeting to increase the impact and effectiveness of its social assistance programs. The Government is firmly committed to establishing a national social protection floor in the context of a difficult macroeconomic and social situation, and limited fiscal space. Current beneficiaries of social assistance programs are selected based on a combination of self-declared income, household size, household members unable to work and other subjective criteria. The reliance on these subjective eligibility criteria has inherent risks. As a result, the main social assistance program (the cash transfer program PNAFN) has only up to 50 percent of targeting accuracy, based on 2014 data.[27] Tunisia needs to improve the targeting accuracy of its social assistance programs using objective and transparent criteria. By targeting poor and vulnerable households more accurately, through a proxy means test, social assistance programs can increase their impact within their budget limitations. Furthermore, a new targeting mechanism will be able to serve as the backbone of the future expansion of social assistance programs[28] while ensuring fiscal soundness and effectiveness.

93. ***Policy reform:*** The Government's Five-Year Plan 2016-2020 and Economic and Social Reform Roadmap 2018-2020 also cover social sector reforms, with the aim of achieving greater transparency, equity and efficiency in social assistance programs and expanding their coverage. In 2017, the Council of Ministers approved the draft Social Protection Law (*Loi Organique Amen Social*) and transmitted it to Parliament for approval.

[27] CRES and African Development Bank, 2017, « Evaluation de la performance des programmes d'assistance sociale en Tunisie, pour optimiser le ciblage des pauvres et freiner l'avancée de l'informalité ». The report is available online : http://www.cres.tn/uploads/tx_wdbiblio/Rapport_CRES_mai_2017.pdf. According to this report, about 50 percent of PNAFN beneficiaries belong to the poorest decile. However, the methodology used in the report has some weaknesses that is likely to induce recall bias and hence to artificially improve targeting accuracy. The 50 percent targeting accuracy reported in the report should therefore be interpreted as an upper bound. There is no recent survey in Tunisia that collects both welfare information and participation in PNAFN and AMG II programs to estimate the benefit incidence of these programs using the methodology accepted across the world.

[28] In terms of coverage, the PNAFN cash transfer program covers about 8 percent of the population (with monthly transfers amounting to TND 180 per family as of April 2018) while the reduced-fee health services program (AMG I and II) covers 22 percent of the population. In comparison the poverty headcount was estimated in 2015 by the National Institute of Statistics at 15.2 percent (2015 poverty line of TND 142 per capita per month) and the extreme poverty headcount stood at 3 percent (2015 poverty line of TND 86 per capita per month).

The relevant parliamentary commission completed final validation of the draft Law in early April 2018 for plenary discussion and vote. This draft Law defines the role of the Ministry of Social Affairs in determining the beneficiaries of social assistance programs using transparent, objective and equitable criteria, as well as the principles for its implementation of a new targeting model (Chapter 2, Article 8). The model was developed by the Research Center for Social Studies (*Centre de Recherche et d'Etudes Sociales,* CRES) in coordination with the National Institute of Statistics and the Ministry of Social Affairs. Based on the draft Law, the new targeting procedure, new targeting model and revised administrative processes will be adopted through an order of the Ministry of Social Affairs. Key implementation procedures such as outreach, registration and grievance redress have also been designed.

94. ***Expected results:*** Finalization of the targeting model and key implementation procedures and their approval by the Council of Ministers have prepared the ground for the prompt formal adoption of these tools once the Social Protection Law is ratified by Parliament. These tools are critical for an efficient expansion of the safety nets. The reform will also contribute to improving the transparency of social assistance programs. The results indicator[29] for the prior action is the application of the new targeting model to the database of the two main social assistance programs and the households on the waiting list. A report will be prepared by CRES and the Ministry of Social Affairs to document the results. The achievement of this step is critical for the Government to determine what portion of the poor and vulnerable are included and excluded (targeting performance), and develop and implement a policy to improve coverage in a targeted manner.

95. ***Implementation support and complementarities with other IFIs:*** Implementation of the reform will be supported through the Social Protection Reform Support Project (financed by MENA Transition Fund). The IMF EFF program also supports Government efforts to strengthen social assistance through improved targeting and increased social spending. In particular, the establishment of the social registry (a database of the poor and vulnerable population) under the Social Protection Reform Support Project is a structural benchmark of the IMF EFF program.

Prior Action #10: To protect the poor and promote their human capital, the Borrower's Minister of Social Affairs has established an inter-ministerial working group to prepare the design (including objectives, interventions, budget and key institutional arrangements) of a new social protection program with cash transfers and complementary services to poor households with children 0 to 18 years old, pursuant to the Borrower's Minister of Social Affairs' Decision dated April 2, 2018.

96. ***Rationale:*** There are important geographic disparities in access and quality of basic infrastructure and services in Tunisia, resulting in unequal human development and labor market outcomes. Students in lagging regions face higher levels of repetition and school leaving and greater deficiencies in the quality of nutrition (Tunisia Systematic Country Diagnostic). The current social protection system is unable to effectively respond to this

[29] More ideal results indicator for this prior action would be the level of inclusion and the exclusion errors. However, the data are not available, as the INS household survey did not properly capture the beneficiaries of main social assistance programs. The INS survey will revisit the formulation of the relevant question for the next round of the household survey, scheduled for 2020.

challenge due to the high level of fragmentation and low coverage of existing programs. The PNAFN serves mainly the elderly poor with a priority focus on the disabled. As a result, more than 60 percent of beneficiaries are above 60 years old, and about 30 percent have benefited from the program for more than 20 years. In addition, PNAFN only allocates TND 10 per child (with a maximum of 3 children) and there is little follow-up or means to effectively address attendance, school leaving and nutrition issues.

97. ***Policy reform:*** This policy reform supports the first step towards the development of a cash transfer program for children's human capital: the creation of an inter-ministerial committee that will have as its mandate the formulation of the key objectives, interventions and key institutional arrangements for such a program. The reform will help to address institutional and coordination weaknesses that would undermine the effectiveness of the human capital cash transfer program. In particular, it will help in improving coordination between the supply of education and health services and the delivery of cash transfers. The committee is chaired by the Ministry of Social Affairs and includes the Ministries of Finance, Development, Education, Health, and Family and Childhood. The ministerial order establishing the committee provides the institutional basis for this program.

98. ***Expected results:*** Expected long-term results include improvements in terms of human development outcomes at household level, including reduced levels of school leaving and increased adherence to vaccination schedules among beneficiary households. However, the results in the near term (by the end of 2019) will be at the level of Government policy and financing decisions leading to the actual launch of the program. Achieving these results will require a package of measures, including the adoption by the Council of Ministers of the program's objectives, interventions, impact evaluation framework, budget and key institutional arrangements. Therefore, the results indicator for the prior action is the finalization of the program design and submission to the Council of Ministers. The Government plans to undertake large consultations and discussions with social partners under the tripartite Social Protection Commission (Government, UGTT, UTICA) prior to approving the program.

99. ***Implementation support and complementarities with other IFIs:*** This reform is supported through: (a) joint technical assistance with UNICEF on a child cash transfer pilot; and (ii) the Social Protection Reform Support Project (financed by MENA Transition Fund).

Prior action #11: To improve access to micro-credit for income generating activities, the Borrower's Minister of Finance has raised the loan amount ceiling for micro-credits, pursuant to the Borrower's Minister of Finance's Arrêté dated **April 13, 2018 and published** ***in the Official Gazette No. 31, dated April 17, 2018.***

100. ***Rationale:*** The microfinance market in Tunisia is still underdeveloped, although it is undergoing rapid transformation. A 2011 law-decree created a dedicated supervisory body (*Autorité de Contrôle de la Microfinance*, ACM) and paved the way for microfinance institutions, MFIs (*Institution de Microfinance, SA*) to emerge and grow, but the restructuring of subsidized and loss-making microcredit associations (MCAs) remains a major obstacle. The Ministerial Order of January 18, 2012 sets the maximum microfinance loan size by

regulated MFIs at a very low level: TND 20,000.[30] While this cap was set with a view to channeling sector resources towards the most vulnerable population, it has limited the ability of MFIs to extend credit to the upper micro and very small enterprises. With the current ceiling, MFIs are unable to meet the needs of successful micro-entrepreneurs who want to borrow more than the TND 20,000 limit and are excluded from the banking sector given small requested loan sizes and the semi-formal nature of the enterprise. These limitations have become more acute as price levels have increased, thereby lowering the real value of the loan ceiling.[31] Currently, MFIs play an important role in promoting greater productive economic inclusion. More than 85 percent of microcredit lending is for income-generating activities, particularly for women and youth, who account for 57 percent[32] and 26 percent[33] of microcredit loans, respectively.

101. ***Policy reform:*** To meet the growing needs of micro-entrepreneurs while maintaining access to microfinance by vulnerable populations, the Minister of Finance has issued a new Ministerial Order on April 13, 2018, which revises the January 18, 2012 Order, that raises the maximum microfinance loan size to TND 40,000 for MFIs. The revision will be calibrated to ensure that the sector still serves the needs of the most vulnerable population, particularly women, and ensures sound risk management within MFI credit portfolios by: (a) setting a minimum percentage of smaller microloans (below TND 20,000) by MFIs, thus preserving the volume of loans targeted at women and most vulnerable groups, (b) introducing criteria for MFIs to offer larger microloans, through requirements on levels of portfolio-at-risk and minimum capitalization. In addition, the Government has over the last year strengthened the capacity of the Microfinance Regulatory Authority to undertake supervisions of all five private MFIs.

102. ***Expected* results:** The reform will contribute to increasing access to microcredit for micro and very small entrepreneurs, improving their ability to venture into income-generating activities while preserving access to microfinance for vulnerable groups, including women. It is expected that the reform will improve access of vulnerable groups in lagging regions. MFIs will also be able to provide further financing for start-up activities for unemployed/newly graduated youth, as those activities need bigger loans than what the existing ceiling allows. Furthermore, while microenterprises are good for self-employment, upper micro and very small enterprises, when they are given the opportunity to grow, tend to create jobs for the poor. The reform will also contribute to the achievement of objectives set by the national strategy on social and solidarity economy currently being finalized by the Government. The

---

[30] The Ministerial Order of January 18, 2012 sets the maximum loan size at TND 3,000 for MCAs. Regional experience concerning microfinance loan amount ceilings varies. A 2016 IFC study covering 10 countries in the MENA region found that 6 countries have microfinance loan ceilings that range from 89 to 547 percent of GNI per capita, with Tunisia standing a 94 percent. Four countries (Jordan, Lebanon, Iraq and Palestinian Territories) have elected not to have a ceiling. Source: IFC (2016) Serving the Very Small Enterprise Segment by Microfinance Institutions in the Arab World.

[31] TND 20,000 in 2012 are equivalent to about TND 30,500 (accounting for the depreciation of the dinar against the Euro), TND 31,700 (accounting for the depreciation of the dinar against the US dollar), or TND 27,100 (accounting for wage inflation).

[32] Sector data. Source: Microfinance Regulatory Authority.

[33] The youth data are from the largest MFI.

results indicator for the proposed operation is the increase in volume of microcredits disbursed for income-generating activities from TND 731 million (of which TND 372 million for women) to TND 1,175 million (TND 600 million).[34]

Analytical underpinnings

103. **The proposed DPF builds on the work undertaken as part of the Tunisia Development Policy Review (DPR) and the Systematic Country Diagnostic (SCD), as well as technical assistance activities and regional and global analytical reports.** The Tunisia DPR and SCD provide the analytical underpinnings for most of the reforms supported by the proposed DPF. The SCD identifies macroeconomic and fiscal stability as a prerequisite for growth and job creation, and for achieving the WBG twin goals of eradicating extreme poverty and boosting shared prosperity in a sustainable manner. The DPR and SCD both argue that the Tunisian economy has failed to generate enough good jobs because it is burdened by a system of rents and privileges that thrives on the pervasive web of regulations and restrictions. This system stifles competition and protects privileged firms, obstructing the development of a dynamic economic environment. The World Bank regional report *Jobs or Privileges*[35] provides evidence that in this context entrepreneurship is constrained, with very few firms entering the market every year and most new entrants remaining small or exiting after three to five years of existence. The DPR and the SCD both recommend actions to remove rents, increase competition, open the economy and promote entrepreneurship. In addition, several technical assistance and project preparation activities (recent and ongoing) are aimed at diagnosing the existing institutional and legal framework and designing and calibrating reforms in the areas of energy, social protection and public finance management.

Table 1: DPF Prior Actions and Analytical Underpinnings

Prior actions	Analytical Underpinnings
Operation Pillar 1: Removing barriers to investment, trade and entrepreneurship	
Prior action #1: To stimulate private investment and building on an exhaustive mapping of investment authorizations, the Borrower has approved a reduced list of economic activities that remain subject to authorizations, and defined the deadlines and procedures for processing authorization requests of economic activities under said reduced list, pursuant to Borrower's Governmental Decree No. 2018-417, dated May 11, 2018 and published in the Official Gazette No. 38 dated May 11, 2018.	The IFC and World Bank (FCI Advisory Unit) technical assistance reports Development Policy Review: World Bank (May 2014), *The Unfinished Revolution. Bringing Opportunity, Good Jobs and Greater Wealth to All Tunisians;* Report No. 86179-TN; and associated background papers Tunisia Systematic Country Diagnostic, 2015

[34] Microcredits towards income-generating activities are in the agriculture, handicrafts, small industry, commerce and services sectors and exclude microcredits relating to housing, education, health and consumption needs.
[35] World Bank MENA Regional Report: 2015, *Jobs or Privileges – Unleashing the Employment Potential of the Middle East and North Africa.*

Prior action #2: To reduce the time and cost to export and improve the transparency of trade procedures, the Borrower has made mandatory the digitization of all export and import procedures and the connection of all institutional stakeholders involved in trade to the Tunisia Trade Net platform by the end of 2018, pursuant to Borrower's Conseil Supérieur des Exportations Decision dated January 4, 2018.	World Bank, Tunisia: *Advancing Tunisia's Global Integration*, June 2014. Djankov, Freund, and Pham, 2006, *Trading on Time*, World Bank Policy Research Working Paper 3909, May 2006. ISTIS and IACE Compliance Cost Savings Surveys, 2013 and 2015.
Prior action #3: To improve SMEs access to markets, the Borrower has made e-procurement (through TUNEPS) mandatory for public procurement pursuant to the Borrower's Governmental Decree No. 2018-416 dated May 11, 2018, published in the Official Gazette No. 38, dated May 11, 2018, modifying and complementing Decree No. 2014-1039 dated March 13, 2014 regulating public procurement.	Tunisia Public Expenditure and Financial Assessment, PEFA, 2016
Prior action #4: To improve SMEs access to finance, the Borrower's Council of Ministers has approved and transmitted to Parliament the draft Law on Secured Transactions aligned with the UNCITRAL Legislative Guide on Secured Transactions, pursuant to Borrower's Council of Ministers' decision dated May 7, 2018 and Transmittal Letter to the Parliament dated May 16, 2018.	World Bank, IFC and USAID technical assistance
Prior Action #5: To improve SMEs access to finance, the Borrower has improved the financial products offered by the SME Credit Guarantee Fund, its operating and payment procedures and its risk management framework, pursuant to an agreement (Convention) between the Borrower's Ministry of Finance and the Société Tunisienne de Garantie dated April 18, 2018.	
Operation Pillar 2: Moving towards a more efficient, sustainable and inclusive energy sector	
Prior action #6: To contain the electricity and gas subsidies, the Borrower has approved an electricity and gas tariff adjustment in line with its Energy Subsidy Reduction Policy Note, pursuant to the Borrower's Minister of Energy, Mines and Renewable Energy's Letter addressed to STEG dated May 10, 2018.	World Bank technical assistance World Bank Public Expenditure Review (PER), ongoing World Bank and UN technical assistance of energy regulator
Prior action #7: To improve the performance of the STEG through actionable performance contracts, and greater accountability, the Executive Board of STEG and the Borrower's Minister of Energy, Mines and Renewable Energy have approved a commercial action plan for STEG to reduce losses and improve collection of bills, in line with the objectives of STEG's performance contract for 2016-2020, pursuant to Borrower's Minister of Energy, Mines and Renewable Energy's Letter dated April 18,	World Bank technical assistance

Prior action #8: To improve the energy mix, the Borrower has adopted a decision to scale up and accelerate the implementation of Tunisia's Renewables Plan through private sector owned renewable energy capacity, pursuant to Borrower's Council of Ministers' Decision dated February 28, 2018.	World Bank and GiZ technical assistance
Operation Pillar 3: Promoting greater economic and social inclusion	
Prior action #9: To establish the foundation for a well targeted and fiscally sound expansion of the coverage of social safety nets, the Borrower's Council of Ministers: (i) has approved and transmitted to Parliament the Social Protection Draft Organic Law (Loi Organique Amen Social) which, in particular, establishes the principle of targeting of safety net programs; and (ii) has approved the new targeting model, including key implementation procedures, all pursuant to Borrower's (i) Council of Ministers' Decision dated September 13, 2017 and transmittal letter to Parliament dated December 26, 2017, and (ii) Council of Ministers' Decision dated May 7, 2018, respectively.	Research Center for Social Studies (CRES) and African Development Bank (2017). *Evaluation of performance of social assistance programs in Tunisia* World Bank technical assistance and reform support project World Bank Public Expenditure Review (PER), ongoing Out of School Children in Tunisia (UNICEF report, 2017)
Prior Action #10: To protect the poor and promote their human capital, the Minister of Social Affairs has established an inter-ministerial working group to prepare the design (including objectives, interventions, budget and key institutional arrangements) of a new social protection program with cash transfers and complementary services to poor households with children 0 to 18 years old, pursuant to the Borrower's Minister of Social Affairs' Decision dated April 2, 2018.	
Prior action #11: To improve access to micro-credit for income generating activities, the Borrower's Minister of Finance has raised the loan amount ceiling for micro-credits, pursuant to the Borrower's Minister of Finance's Arrêté dated April 13, 2018 and published in the Official Gazette No. 31, dated April 17, 2018.	World Bank and IFC technical assistance. World Bank – CGAP study on financial Inclusion (September 2015)

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

104. The proposed operation is aligned with the WBG strategic priorities. The proposed operation is aligned with the WBG twin goals of ending extreme poverty and boosting shared prosperity in a sustainable manner. It contributes to the implementation of the WBG MENA strategy by promoting reforms that foster entrepreneurship and encourage private investment and trade, in line with its pillars on renewing the social contract and regional cooperation. The proposed operation supports the Government in achieving its social and economic vision of inclusive and sustainable development as outlined in the Five-Year Development Plan 2016-

20. It is directly linked to the objectives outlined in the WBG Tunisia Country Partnership Framework (CPF) for 2016-2020 under Pillar 1 (Restoring an Environment Conducive to Sustainable Economic Growth and Private Sector-Led Job creation) and Pillar 3 (Promoting Increased Social Inclusion). In particular, the proposed reforms are in line with CPF Objective 1.1, which aims to achieve sound macroeconomic and fiscal management of the economy; and with CPF Objectives 1.2 and 1.3, which seek to improve the enabling environment for private investment and trade, as well as increase access to finance for SMEs and innovative enterprises. The operation's support for economic and social inclusion is directly aligned with CPF Objectives 3.2 and 3.3. A political economy filter has been applied to the proposed operation with the aim of improving its effectiveness and impact by identifying and responding to relevant governance and political economy constraints and opportunities (Annex 7).

105. **The proposed operation builds on the findings and lessons learned from the CPF Performance and Learning Review (PLR).** The PLR highlights the need to, inter alia, promote innovative solutions for entrepreneurship and SME development; strengthen engagement on social protection and inclusion, particularly in lagging regions; and increase WBG engagements on climate change mitigation and adaptation. The proposed DPF incorporates some of these findings by supporting more tangible reform actions that aim to simulate private investment and entrepreneurship, enhance social inclusion, and address inefficiencies and the need for more renewables in the energy sector.

106. **In addition, the WBG is providing analytical and advisory services (ASA) to the Government in support of the reforms across the three pillars of the DPF.** The implementation support provided are described in detail under each pillar and prior action, including detailed assessments of complementarities and synergies with the IMF and other IFIs.

107. **The operation will also contribute to implementing the Maximizing Finance for Development approach in Tunisia. While the IFC already has a strong presence in Tunisia, the DPF-supported reforms are expected to crowd in additional IFC and private sector investors in key economic sectors.** IFC's investment portfolio in Tunisia amounts to roughly US$300 million spread across 13 companies in key sectors including agribusiness, financial services, health care, infrastructure and ICT. In addition, IFC advisory services include support for the development of finance institutions for MSMEs and entrepreneurs (in collaboration with the IBRD), as well as support for PPP development, including capacity-building and advice on identification and execution of PPP transactions. In 2017, IFC invested US$30 million in BTK (*Banque Tuniso-Koweitienne*) to enhance access to finance for MSMEs, and also launched the Tunisia Women Banking Champions' initiative, which will provide financing and advisory services to banks to enable them to better design financial services for women. The reforms supported under the DPF, in combination with the ongoing WBG technical assistance provided to the Government, are expected to catalyze further IFC investment in Tunisia, with a particular focus on PPPs in renewable energy, ports and desalination plants.

4.4 CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

108. **The Government has undertaken consultations with key stakeholders on the prior actions and reforms supported by the DPF.** In 2017, the Government conducted consultations on the key reform areas as part of the preparation of the *Note d'Orientation Stratégique* and the Five-Year Plan. In 2018, the Government undertook additional consultations to solicit feedback on the specific reforms and priority actions proposed for the DPF.

109. **In addition, the Bank regularly undertakes consultations with key civil society organizations on the reform program and its analytical underpinnings.** These consultations confirm that the content of the program generally enjoys broad support, as the reforms are deemed essential for Tunisia's economic transformation. The Bank continues to have excellent collaboration with the EU, the AfDB, UN agencies, AFD and the Japan International Cooperation Agency (JICA), all of which have a strong presence in Tunisia.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

110. **A detailed Poverty and Social Impact Analysis (PSIA) on prior action #6 (electricity and gas tariff adjustment) has been prepared (see summary below and detailed analysis in Annex 5).** The remaining prior actions were also reviewed for their potential impact on poor and vulnerable households via price or employment effects (see summary in Annex 6). Using the latest 2015 Tunisian household survey, the PSIA on prior action #6 estimates the direct effect on household well-being of electricity and gas tariff adjustments. Using the 2010 input-output matrix in combination with the household survey, the PSIA also estimates the indirect effect via changes in prices of all other products. In addition, the costs and benefits of the Government's recently introduced compensation mechanisms were simulated. The main caveat of this analysis is that the Tunisian household survey does not allow separation of the electricity bill from the gas bill. Since poor and low-income households consume much less gas than the more well-off households, the analysis provided in this document may underestimate the progressive nature of the reform.

111. **The simulations in the PSIA were based on an average price increase of 7.1 percent as enacted in May 2018 and 7.1 percent per annum over the next 2 years, with higher price increases for larger consumers.** Compared to the baseline, the electricity price in 2020 would be 23 percent higher. The impact assessment shows that these adjustments would result in welfare losses for the bottom 40 percent of around 0.6 percent of expenditures within one year and would average 2 percent of expenditures within 2 years. Consequently, poverty would increase by 0.5 to 0.8 percent within one year and by 1.2 percent point by 2020. Poverty increases would be larger in inland regions.

112. **To compensate the poor and vulnerable for the effects of tariff adjustments, the Government recently announced measures to increase cash transfer amounts and minimum pension by about 20 percent to TND 180 per month.** In addition to these short-term measures, improving the targeting of safety nets will be critical to protecting the poor and vulnerable in the medium term. The simulations show that a 20 percent increase of cash

transfers and minimum pension, as announced by the Government in January 2018 and in effect since April 2018, would lower the poverty headcount from 15.14 percent before the price increase to 14.86 percent in end-2018. However, these measures would not be sufficient to compensate the poor and vulnerable after one year if price adjustments continue, due to their indirect effects. An increase in cash transfers and minimum pension combined with better targeting of cash transfers would achieve this objective and reduce the poverty headcount by up to 1 percentage point.

113. **The Government has also ongoing programs and plans to help low and middle-income households improve energy efficiency and lower consumption,** including through the exchange of inefficient appliances and equipment for more modern, low-consumption ones (e.g., refrigerators, LED light bulbs). The Government's renewable energy action plan also calls for the launch of a social self-generation program for solar roof systems that would benefit around 1.2 million families that consume less than 100 kWh of electricity per month.

5.2 ENVIRONMENTAL ASPECTS

114. **The World Bank has assessed whether any specific policies supported by the proposed operation are likely to cause significant effects on the country's environment and natural resources.** Based on that assessment, a conclusion was reached that the policies supported by the proposed operation are not, in general, likely to lead to negative impacts. In fact, the assessment suggests that the implementation of some policies may lead to positive impacts such a reduction in air pollution. However, some prior actions may lead to adverse environmental impacts if the required Environmental Impact Assessments (EIA) and mitigation plans are not prepared and implemented adequately.

115. **Over the last years, Tunisia has confirmed a consistent, high-level and long-term commitment to environment protection, supporting a green economy and tackling climate change.** Strategic direction for these issues, which are clearly addressed in the 2014 Constitution, is provided by the Five-Year Development Plan (2016-2020), which stresses the importance of a new development model based on efficiency, equity, and sustainability. By laying the foundation for increased interdependence among agriculture, forestry and natural resources, the Government seeks to engage all key actors (public, private, civil society organizations) in strong partnerships while increasing rural household incomes and strengthening the resilience and sustainability of natural resources. Implementation of the accompanying action plan will help to ensure a rational use of natural resources, better environmental protection, and greater control of energy consumption. Furthermore, the National Strategy for a Green Economy in Tunisia focuses on synergies and trade-offs between the environmental and economic pillars of sustainable development, in which economic outputs are directly increased by improved environmental conditions, leading to a virtuous circle of further economic growth.

116. **Climate change severely affects Tunisia as the country is highly vulnerable to five natural disasters: urban flooding, river flooding, coastal flooding, extreme heat, and wildfires.** According to Tunisia's country climate change brief, the arid North African nation is also prone to drought (+10-30 percent frequency and intensity by 2050, -5-10 percent of agricultural GDP, -30 percent of arable land, reduced animal husbandry), higher temperatures

(+2.1C by 2050; 180,000 ha of forests from wildfires by 2030), and sea level rise (+50 cm by 2050, salination of half the nation's aquifers, damage to coastal cities where 65 percent of population lives). These threats to economic development and poverty alleviation, which are already probable, will grow in frequency and severity as temperatures warm, precipitation shifts, and sea levels rise. Tunisia's agricultural sector, which accounts for 10 percent of the economy (2015), will experience volatile disruption and could endanger food security. Natural capital, including forests that cover 6.7 percent of the territory (2015), will also be at risk. Low-income population, like the 15.2 percent of Tunisians who live below the national poverty line (2015), lack the capacity to adapt to climate-induced shocks. Finally, Tunisia like the rest of MENA suffers from acute water insecurity. As highlighted in *Beyond Scarcity* report, water shortages will reduce MENA GDP growth by 6 to 14 percent by 2050. Climate change, in short, will exacerbate all of these vulnerabilities. Unaddressed, it will amplify fragility.

117. **Tunisia's Intended Nationally Determined Contributions (INDC, 2015) and Nationally Determined Contributions (NDC, 2016) recognize the challenge of climate risk and request international assistance to confront it:** US$18.4 billion in mitigation investments to reduce carbon intensity by 41 percent from 2010 levels by 2030 and US$1.7 billion in adaptation investments to protect ecosystems (US$782 million), tourism, coastlines (US$556 million), agriculture, water resources (US$533 million), and public health. Top priorities include restoring degraded pasturelands, creating multi-species forest nurseries, preserving cork oak woods, controlling floods in drainage basins, and building resilience into coastal economic activity. While the Tunisia CPF (2016-2020) does not contain a green pillar, it pledges to combat climate change with an integrated approach, particularly in lagging regions, by supporting the country's adaptation and mitigation agenda.

118. **Tunisia has strong and well-defined institutional, legal and regulatory frameworks concerning the management of social and environmental impacts of investments.** The Ministry of Environment and Local Affairs (MELA) is the key player in the definition and implementation of environmental policies and strategies. It proposes policies related to the environment and ensures the coordination and monitoring of actions by state and local authorities for protection of nature and the environment, and the mitigation of pollution and nuisances. MELA publishes an annual report on the state of the environment, and implements action plans to address various environmental problems related to water, solid waste, biodiversity, natural resources and urban planning.

119. **Overall, the proposed operation is expected to lead to positive impacts on Tunisia’s environment and natural resource base.** The prior actions under pillar 2, aimed at ensuring the sustainability of Tunisia’s energy supply by increasing electricity and gas tariffs, will lead to a reduction in electricity and gas demand and consumption, which will in turn reduce emissions of air pollutants and greenhouse gases. The prior actions will support reducing energy losses by the utilities and improving the enabling environment for investments in renewable technologies. Risks of greater use of biomass by poorer households as a result of the electricity and tariff adjustment will be mitigated by the significant increase in cash transfers and their planned future expansion. It is important for the Government to develop additional measures focusing on protecting vulnerable consumers, particularly efficiency measures for lower-income households to reduce energy consumption and improve affordability. A full menu of options should be considered in order to provide energy services

to the poor and vulnerable, including renewable energy sources and fossil fuels combined with cleaner and more efficient energy technology.

120. **The prior actions under pillar 1 aimed at removing barriers to investment, trade and entrepreneurship are expected to contribute to investment growth, which may entail environmental risks and impacts.** However, the environmental regulatory framework and the current institutional capacity in Tunisia are deemed to be adequate to ensure that the necessary environmental management and mitigation measures are in place. Any industrial, commercial or agricultural activities that may result from the reforms supported under the proposed operation, and may have a significant effect on the environment, will be subject to an Environmental Impact Assessment (EIA), which must take place before licensing and investments under such activities.

121. **The prior actions under the third pillar are likely to have overall positive effects on environment, forests and natural resources.** More specifically, prior actions that aim to improve the impact and effectiveness of Tunisia's social assistance programs and promote access to microcredit will likely reduce the pressure on fragile natural resources by providing vulnerable groups and local populations with the means to diversify their livelihoods. However, it should be stressed that microfinance institutions, as financial intermediaries, need to adhere to sound environmental and social management practices and screen the activities they finance to ensure that they are prepared and implemented in accordance with sound environmental and social management practices and national law. The environmental and social safeguards management framework developed under the World Bank-financed Tunisia Micro, Small and Medium Enterprise Development Project could be used as reference in this regard.

5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

122. **Overall, the fiduciary risk of the operation is rated Moderate.** The 2016 Public Expenditure and Financial Accountability assessment (PEFA), complemented by subsequent assessments such as the joint IMF/World Bank Public Investment Management Assessment (PIMA) and Public Financial Management (PFM) Master Plan, both from 2018, concluded that the legal and administrative framework for PFM offers a level of assurance regarding reliability of information, predictability and control in budget execution, and a strong control environment. However, the PEFA diagnostic also identified weaknesses related to budget comprehensiveness, transparency and accountability, as well as shortcomings related to the level of aggregation of information, policy-based budgeting, and accounting, recording and reporting. Regarding the level of budget comprehensiveness and transparency, the PEFA diagnostic reported that the Government has made great efforts to increase budget transparency through the Mizaniatouna initiative, which incorporates programmatic, performance-based budgeting in an online open budget platform. Fiscal reporting has also made notable progress,[36] although the quality of fiscal data needs to be improved through accounting reform. A new

[36] 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 (link: http://www.finances.gov.tn). Budgets since 2003 are available online. In line with the reforms supported by the First GOJ DPF, 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".

Organic Budget Law, currently under review by Parliament, proposes to introduce changes related to the results orientation of the budget process, the use of a multi-year expenditure framework, and compliance with international standards. The Law is expected to be adopted by end of 2018.

123. **The *Note d'Orientation* identified public sector governance and public financial management as key priorities.** In response, the Five-Year Development Plan supports strategic public sector governance and PFM reforms.

124. **The first safeguards assessment of the Central Bank of Tunisia (CBT), undertaken in 2012 by the IMF, found an adequate control environment for day-to-day operations but a need for greater oversight, autonomy and transparency.** The CBT has confirmed its commitment to implementing these recommendations, some of which are already part of its reform agenda. The statutory audit reports on Central Bank Financial Statements covering calendar years 2015 and 2016 have an unmodified audit opinion and no major deficiencies were identified by the external auditor.

125. **The proposed loan will follow the World Bank disbursement procedures for development policy financing.** After the loan has been approved by the World Bank Group's Board of Executive Directors and becomes effective, the proceeds will be disbursed in one tranche and in compliance with the stipulated release conditions as defined in the General Conditions and following Government of Tunisia practices for receiving funds related to policy-based loans. At the Government's request, the proceeds of the loan will be first deposited by the World Bank into a dedicated Deposit Account[37] held at the CBT, which forms part of the country's official foreign exchange reserves. An equivalent amount in local currency will be credited to the single Treasury Account. The conversion will be based on the prevailing exchange rate on the date the funds are credited to the Treasury Account. Within 30 days of disbursement, the Government will report to the World Bank, by written confirmation, on the amounts deposited**.** The confirmation will include the local currency amount credited to the account that is used to finance budgeted expenditures, the exchange rate applied and the date of the transfer. If the proceeds of the loan are used for ineligible purposes as defined in the General Conditions, the World Bank will require the Borrower to promptly, upon notice, refund an amount equal to the amount of the ineligible payment. Amounts refunded to the Bank upon such request shall be canceled. The loan proceeds will be administered by the Ministry of Finance.

126. **Although an audit of the use of the funds may not be required, the Bank reserves the right to ask for an audit of the dedicated Deposit Account,** where all withdrawals from the loan account will be deposited, if the fiduciary risk of the operation increases because of changes in the control environment. This audit, if requested, will cover the accuracy of the debits and credits made under the account, including accuracy of exchange rate conversions; and will confirm that the account was used only for the purposes of the operation and that no other

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

amounts have been deposited into the account. The timeline for submission of the audit report to the Bank is no later than six months from the date a request for such audit is issued.

5.4 MONITORING, EVALUATION AND ACCOUNTABILITY

127. **Implementation and coordination responsibilities.** Responsibility for implementing the program rests with the Ministry of Development, Investment and International Cooperation, which coordinates all relevant activities with other ministries. The MDIIC will also take the lead in monitoring implementation progress. Given the important policy implications of the program, the Prime Minister's office and the Ministry of Finance are also involved in the program design, implementation and monitoring.

128. **Supervision by the Bank.** Regular supervision will allow the Bank to continue providing policy advice and technical assistance to the institutions involved in implementing the reform program. The Bank will maintain continuous dialogue with the relevant ministries and will conduct regular reviews in close collaboration with other partners, including supervision missions in the case of specific reforms. The continuous policy dialogue and the Bank's engagement with the medium-term reform agenda will underpin the supervision process.

129. **The availability of data is generally sufficient to monitor progress, but with some areas of difficulty.** The Bank and other development partners will continue to provide support to the Government to improve data quality and management, strengthen monitoring and evaluation, and enhance the Government's capacity to use development outcomes to inform policymaking.

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

6. SUMMARY OF RISKS AND MITIGATION

131. **The overall risk rating of this operation is High.** The major risks to the operation's ability to achieve its development objective include: (a) political and governance risks; (b) macroeconomic risks; (c) institutional capacity for implementation and sustainability; (d) stakeholder risks; and (e) security risks. Details for each of these areas are provided below:

132. *Political and governance:* A national unity Government, formed in late August 2016, has supported greater participation of civil society and accountable decision-making during preparation of this operation to ensure support for the proposed reforms. However, the effectiveness of the national unity Government will be severely tested if the economic and social situation degrades further before the presidential and parliamentary elections in late 2019. Progress on the economic and job fronts and on containing inflation will be critical to lower social tensions. However, opposition to reforms that could improve the situation might arise from entrenched economic and social interest groups, including business groups and workers unions. A better understanding of such interest groups, including through political economy analysis, can help identify ways to ensure their buy-in. In addition, opposition to the energy subsidy reform may come from the middle class and from sectors with high energy intensity. The proposed mitigation measures to help the poor and vulnerable, the Government's measures to support energy transition, and open communication will help mitigate these risks.

133. *Macroeconomic*: The macroeconomic situation has deteriorated sharply over the past year and is very fragile: fiscal deficits remain high and debt is above the 70 percent debt-to-GDP benchmark for emerging markets. The current account reached an exceptionally high 10 percent of GDP and reserves have plummeted to below 80 days of import cover. Continued acceleration of inflation is a major risk. This highlights the urgent need for corrective macroeconomic and fiscal measures, including greater exchange rate flexibility, monetary policy tightening if inflation continues, and implementation of wage bill, energy subsidy and pension reforms. The Government is committed to fiscal consolidation and macroeconomic stability, including through the IMF EFF program. The IMF program provides a strong policy anchor for macroeconomic stability, and more frequent monitoring is critical for strong program implementation given the elevated macroeconomic risks. To this end, the Government and the IMF have agreed to move to quarterly reviews and to introduce a new monthly indicative target to facilitate monitoring of the reserve cover on net Central Bank foreign exchange interventions. The World Bank and several other bilateral and multilateral institutions (the EU, AfDB, EBRD, KfW and AFD) are providing technical and financial support to accelerate the implementation of structural reforms.

134. *Institutional capacity for implementation and sustainability:* While the Government has made progress on the reform front, some bottlenecks persist. First, Parliament has a busy schedule with multiple important political and economic regulations pending review and vote. In addition, some political groups in Parliament may oppose key reforms. Capacity building provided to parliamentary commissions, and positive political messaging around reforms from a range of international actors, as well as more action-oriented measures under the control of Government, could help mitigate these risks. Second, coordination across agencies and ministries can be challenging for certain actions, as was the case in the previous DPFs. Opposition from part of the administration can lead to incomplete reform implementation. The Bank's technical assistance and financing support throughout the adoption and implementation processes, along with consistent consultations with civil society and unions, can help to mitigate those risks.

135. *Stakeholders:* The Government has been taking a gradual and consensus-building approach to reforms to maintain social peace. One aspect of this process is a tripartite (Government, unions, employers) commission that meets regularly to discuss the costs and

benefits of the proposed reforms. Over the past year, the Government has also taken a more proactive stance toward communicating the need for reforms and is integrating public consultation and awareness dimensions its reform programs. Importantly, such communication efforts will need to highlight the costs to the broader community of not reforming in terms of foregone growth and financial sustainability, loss of competitiveness, currency depreciation and higher inflation. The Bank is also investing considerable effort in awareness raising, building shared diagnostic tools among stakeholders, and strengthening the Government's communication capacity and efforts.

136. *Other (security):* A significant deterioration of the domestic and regional security situation, particularly in neighboring countries, could negatively affect Tunisia's economic outlook, change the Government's reform priorities or derail its reform efforts. To mitigate this risk, the Government has increased security and defense spending and intensified the fight against terrorism.

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

ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions	Results framework		
	Indicator	**Baseline (2017)**	**Target (2019)**
Pillar 1. Removing barriers to investment, trade and entrepreneurship			
Prior action #1: To stimulate private investment and building on an exhaustive mapping of investment authorizations, the Borrower has approved a reduced list of economic activities that remain subject to authorizations, and defined the deadlines and procedures for processing authorization requests of economic activities under said reduced list, pursuant to Borrower's Governmental Decree No. 2018-417, dated May 11, 2018 and published in the Official Gazette No. 38 dated May 11, 2018.	Number of investment entry authorizations eliminated or simplified (through specifications).	Eliminated (0) Simplified (0)	Eliminated (10) Simplified (17)
Prior action #2: To reduce the time and cost to export and improve the transparency of trade procedures, the Borrower has made mandatory the digitization of all export and import procedures and the connection of all institutional stakeholders involved in trade to the Tunisia Trade Net platform by the end of 2018, pursuant to Borrower's Conseil Supérieur des Exportations Decision dated January 4, 2018.	"Foreign Trade Certificate", "Merchandise Loading Certificate", and "Notice of Arrival of Imported Merchandise" trade procedures are dematerialized. Time to issue the "Foreign Trade Certificate", average number of days.	No 7 days	"Foreign Trade Certificate", "Merchandise Loading Certificate", and "Notice of Arrival of Imported Merchandise" trade procedures are dematerialized. 3 days
Prior action #3: To improve SMEs access to markets, the Borrower has made e-procurement (through TUNEPS) mandatory for public procurement pursuant to the Borrower's Governmental Decree No. 2018-416 dated May 11, 2018, published in the Official Gazette No. 38, dated May 11, 2018, modifying and complementing Decree No. 2014-1039 dated March 13, 2014 regulating public procurement.	Share of public entities conducting their procurements through TUNEPS Share of public contracts awarded to SMEs	Ministries (84%) SOEs (45%) Parastatals (34%) 17% (based on a non-random sample of 32 public entities)	Ministries (100%) SOEs (60%) Parastatals (50%) 20% (based on a random sample of public entities)

Prior action #4: To improve SMEs access to finance, the Borrower's Council of Ministers has approved and transmitted to Parliament the draft Law on Secured Transactions aligned with the UNCITRAL Legislative Guide on Secured Transactions, pursuant to Borrower's Council of Ministers' decision dated May 7, 2018 and Transmittal Letter to the Parliament dated May 16, 2018.	E-registry for movable collateral is established and operational	No	Yes
Prior Action #5: To improve SMEs access to finance, the Borrower has improved the financial products offered by the SME Credit Guarantee Fund, its operating and payment procedures and its risk management framework, pursuant to an agreement (Convention) between the Borrower's Ministry of Finance and the Société Tunisienne de Garantie dated April 18, 2018.	Volume of SME loans guaranteed by Sotugar	TND 437 million	TND 500 million
Pillar 2. Moving towards a more efficient, sustainable and inclusive energy sector			
Prior action #6: To contain the electricity and gas subsidies, the Borrower has approved an electricity and gas tariff adjustment in line with its Energy Subsidy Reduction Policy Note, pursuant to the Borrower's Minister of Energy, Mines and Renewable Energy's Letter addressed to STEG dated May 10, 2018.	Electricity and gas subsidies, percentage of GDP[38]	1.2%	1%
Prior action #7: To improve the performance of the STEG through actionable performance contracts, and greater accountability, the Executive Board of STEG and the Borrower's Minister of Energy, Mines and Renewable Energy have approved a commercial action plan for STEG to reduce losses and improve collection of bills, in line with the objectives of STEG's performance contract for 2016-2020, pursuant to Borrower's	Transmission and distribution losses of the power utility, percentage of generated power	16.4% (2016) 76% (2016)	12.5% 82%

[38] The subsidy estimate uses the price-gap methodology which defines energy subsidies as the difference between the domestic market price and the total cost of supply, including production, transport, and distribution costs and taxes, multiplied by domestic consumption. The production cost is based on the price of Brent.

Minister of Energy, Mines and Renewable Energy's Letter dated April 18, 2018.	Rate of collection of bills (electricity and gas), percentage of total bills		
Prior action #8: To improve the energy mix, the Borrower has adopted a decision to scale up and accelerate the implementation of Tunisia's Renewables Plan through private sector owned renewable energy capacity, pursuant to Borrower's Council of Ministers' Decision dated February 28, 2018.	Solar power capacity of private sector owned projects selected under the concession scheme	0 MW	300 MW
Pillar 3. Promoting greater economic and social inclusion			
Prior action #9: To establish the foundation for a well targeted and fiscally sound expansion of the coverage of social safety nets, the Borrower's Council of Ministers: (i) has approved and transmitted to Parliament the Social Protection Draft Organic Law (Loi Organique Amen Social) which, in particular, establishes the principle of targeting of safety net programs; and (ii) has approved the new targeting model, including key implementation procedures, all pursuant to Borrower's (i) Council of Ministers' Decision dated September 13, 2017 and transmittal letter to Parliament dated December 26, 2017, and (ii) Council of Ministers' Decision dated May 7, 2018, respectively.	Targeting model is applied to the database of beneficiaries of the two main social assistance programs (PNAFN and AMG-I and II) and the waiting list.[39]	No	Yes
Prior Action #10: To protect the poor and promote their human capital, the Minister of Social Affairs has established an inter-ministerial working group to prepare the design (including objectives, interventions, budget and key institutional arrangements) of a new social protection program with cash transfers and complementary services to poor households with children 0 to 18 years old, pursuant to the Borrower's Minister of Social Affairs' Decision dated April 2, 2018.	Design of cash transfer program for children's human capital formation is finalized and submitted to Council of Ministers	No	Yes

[39] A report will be prepared by CRES and the Ministry of Social Affairs to document the results of the application of the model.

Prior action #11: To improve access to micro-credit for income generating activities, the Borrower's Minister of Finance has raised the loan amount ceiling for micro-credits, pursuant to the Borrower's Minister of Finance's Arrêté, dated April 13, 2018 and published in the Official Gazette No. 31, dated April 17, 2018.	Volume of microcredits disbursed towards income generating activities (of which for women).	TND 731 million (TND 372 million)	TND 1,175 million (TND 600 million)

ANNEX 2: LETTER OF DEVELOPMENT POLICY

Republic of Tunisia
Ministry of Development, Investment and International Cooperation

May 11, 2018

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

2018 Budget Support Program: Investment, Competitiveness and Inclusion

Mr. President of the World Bank Group,

Strengthened by an **emerging democracy**, which has been crowned by the organization of the **free, multi-party and independent municipal elections**, Tunisia has embarked into a decisive phase in the realization of its economic transition with a strong desire to strengthen its achievements and instill a new dynamic in the economic activity.

Indeed, faced with the delicate economic situation, the Government of the National Unity is keen to ensure a better macroeconomic management policy that reconciles the dual dimension, economic and structural, in the management of public affairs.

Recognizing the acuteness of pressures and fragility of the macroeconomic situation, the Government is undertaking a **finely tuned adjustment effort** in order to restore the soundness of the economic fundamentals and promote a sustainable growth in the medium and long term.

Moreover, it is important to emphasize that the specificity of the year 2018 lies in the fact that it is a pivotal year for the realization of the economic recovery as envisaged by the Development Plan. This economic recovery is highly dependent on progress in the implementation of the economic and social reforms and, in particular, on the impact of economic policy measures adopted to improve the business environment.

An emerging democracy consolidated by the organization of the free, multi-party and transparent municipal elections

The municipal elections held on May 6, 2018 marked the completion of the democratic transition process. These local elections, organized for the first time since the revolution and supervised by the Independent Higher Authority for Elections (ISIE), are likely to lay the **foundations of good local governance** provided for by the new Tunisian constitution.

In addition, the adoption of the **Local Government Code** by the Assembly of People's Representatives represents a consolidation of **local democracy** and of the delegation of important prerogatives to the regions regarding the management of local public affairs. Indeed, this code enshrines the principles of the free Administration of local affairs, the administrative and financial autonomy and participatory democracy.

The adoption of this code is a cornerstone for the gradual introduction of decentralization as a new mode of local governance.

In addition, and with the aim of consolidating the foundations of good governance, transparency and accountability of the actors, the Government is working hard to complete the institutional framework, particularly by accelerating the establishment of independent constitutional bodies, such as the Supreme Council of Magistracy and the Good Governance and Anti-Corruption Authority.

Regarding the **fight against corruption**, the Government of National Unity has repeatedly reiterated its irreversible commitment to fight against this scourge. This commitment is highly reinforced through the establishment of a legal and institutional framework in compliance with international standards, particularly with regard to the Trade Register, securities, the fight against money laundering, and the protection of personal data.

Furthermore, it is worth noting that the **control of the security situation** is ensured thanks to the perseverance of the Government in the process of eradication of the terrorist nexus. This is evidenced by the scale of the operations conducted by both the security and military institutions, which reflects the importance of a security strategy which aims at being proactive and prompt.

Continuous improvement of the business environment ... despite difficult economic situation

Given the acuteness of both structural and economic issues, the Government has paid particular attention to the implementation of major economic reforms to further improve the business environment and make it more attractive.

More specifically, the year 2018 was marked by the setting up of the governance bodies relative to the new Investment Law. This involves the launching of the work of the **Strategic Investment Council** whose main role is to promote the investment effort and improve the business environment through the approval of appropriate global and sectorial strategies. Also, the Tunisian Investment Forum should function as a one-stop shop for investment to guide domestic and foreign investors and facilitate administrative formalities and procedures.

Furthermore, the Government has been committed to substantially reduce the number of investment-related authorizations in order to unlock economic potential and boost investment. A negative list of economic activities subject to authorization will be prepared.

In addition, and under the framework of accelerating the implementation of the components of the **energy transition policy**, an action plan for the acceleration of electricity generation projects based on renewable energies in Tunisia was announced in March 2018. The main guidelines concern the franchising system, the authorization system, the self-production and financing and the governance system of the solar plan.

All of these reforms are supported by the restructuring of the **SMEs' financing** mechanism through the development of microfinance and of private equity industry.

In addition, the adoption of the Organic Law on **Social and Solidarity Economy** is meant to strengthen inclusive development in Tunisia. This law targets a better economic and social inclusion and a shared contribution in terms of creating wealth and jobs.

This concern for economic and social inclusion accelerated the creation of the **Financial Inclusion** Observatory within the Central Bank of Tunisia in November 2017. The main mission of this Observatory is the evaluation and follow-up of access to financial services in Tunisia. The work of this observatory will be consolidated, particularly, by the development of digital finance and micro-insurance.

In addition, the adoption of the **Law on Startups** by the Assembly of People's Representatives is part of the implementation process of the "Startup Tunisia" strategy aimed at making Tunisia an attractive regional hub for emerging companies. This goal aligns with the national priorities relative to digital economy and to boosting youth and innovators' initiative.

Similarly, particular attention has been paid to the **development of value chains with higher value-added** and high job-creation potential in the regions. This orientation reflects the increased willingness to foster synergy between public and/or private investment on the one hand and to provide more effective technical support to small and medium-sized enterprises on the other.

In addition, and under the framework of the mobilization of the **public-private strategic partnership** and the launching of the structuring projects, a high-level conference on the projects to be implemented in PPP mode has been planned to be held during the second half of next June.

Budget consolidation and essential tax reform;

The 2018 Budget Law has been marked by a clear commitment to control public expenditures in order to make public finances regain sustainability. The objective is to contain the budget deficit at around 4.9% of GDP.

This control shall be ensured through the implementation of the civil service reform with its two components: voluntary retirement and negotiated voluntary departure, which will lead to a decrease in the number of civil servants. This is likely to reduce the payroll ratio and to converge towards the ratio of 12.4% that is set as a target for 2020.

At the same time, the 2018 Budget Law calls for a reduction in energy subsidies through the adoption of automatic quarterly adjustments of hydrocarbon prices at the pump.

With regard to revenues, the goal for 2018 is to fight against tax fraud with the broadening of the tax base favoring a better mobilization of budget revenues.

Prudent but proactive monetary policy

In compliance with the Central Bank's powers relative to inflation targeting, the authorities have opted for a tightening of monetary policy through the widening of the corridor from 50 to 200 basis points.

In addition, and faced with the persistence of inflationary pressures, the Central Bank of Tunisia raised the policy rate by 75 basis points in early March 2018.

Overall, the actions of the Central Bank of Tunisia were proactively conducted on the basis of the short- and medium-term inflation profile in order to bring back medium-term inflation rates to acceptable levels allowing the anchoring of the expectations of economic agents.

Social inclusion ... the need for gradual and coordinated structural reforms

As part of its efforts to emphasize a participatory approach based on dialogue and consultation, the Government has established the National Council for Social Dialogue. The council's mission is to organize and manage social dialogue on social and economic issues of common interest to the three social partners.

In addition, and in order to ensure better targeting of social transfers, efforts will be made to review the eligibility and weighting criteria related to social assistance programs for needy families. The project of a "Data Bank on needy and limited-income families" is being finalized in order to establish an efficient information system allowing the management of social assistance programs referring to objective criteria. The goal is to develop a unique social identifier that will help switch from a universal subsidy system to a system that targets needy families.

As for the reform of the social security funds, the control of the funds’ deficit in the coming years is highly dependent on the parametric reform of the retirement system which would result in an increase of the retirement age and an increase of the contributions. However, it should be noted that additional corrective measures are possible in order to guarantee the financial sustainability of the funds.

The objective of improving life conditions in the country's disadvantaged regions urged the Government to develop a strategy of financial inclusion for vulnerable groups and to closely follow-up the progress of public investments that are facing difficulties in the areas of infrastructure and community services.

Moderate recovery of economic activity

The achievements of the first quarter of 2018 confirm the resumption of the pace of growth in some productive sectors, particularly the mechanical and electrical industries and textiles. In addition, an exceptional olive oil picking combined with the revival of tourist activity show that 2018 would be the year of agriculture and tourism par excellence.

However, pressures on inflation and foreign exchange reserves still persist.

Based on the above, the updated 2018 economic forecasts are based on a growth rate of 2.4% in 2018, mainly thanks to a positive contribution of exports and investment.

I. Development Policies and Prospects

The 2016-2020 strategic plan is the first development plan of the Second Republic. It comes to concretize the new vision of Tunisia and to achieve the new model of development which brings together efficiency, inclusion and sustainability.

The strategic axes of the development plan which has been put under the emblem of the reform plan are:

The achievement of good governance, the reform of the administration and the fight against corruption

To this end, a national integrity system will be put in place and the principles of good governance at the sectorial and local levels will be strengthened. The Government will promote the production and dissemination of statistical information in compliance with international standards and guarantee access to information. In addition, the rules of good governance will be applied at the level of public establishments and enterprises.

Moreover, and for the administration to be more effective and at the service of the citizen and development, the reform of the administration shall target the establishment of a particular status of the senior civil service, the building of the administrative competences and the digitization of the administration.

The transformation of the economy into an economic hub

The objective is to diversify the economic fabric in order to ensure a strong export potential and boost job creation. This shall be done through designing appropriate sectorial policies and strategies; improving infrastructure and logistics; optimizing the resources allocated to the national research and innovation system, thereby allowing the improvement of productivity and the rise of value chains at the international level; and creating a conducive framework for innovation and creativity.

In addition, the digital economy will be of great interest. Efforts will be intensified with a view to disseminating digital culture and the digitization of teaching aids, the migration towards an electronic administration at the service of the citizen and the company, setting up the "Tunisia-intelligent" project (off-shoring) in the field of digitization and the development of digital infrastructure.

It is also worth noting that economy transformation is also dependent on the improvement of the business environment and the reforms relative to tax, customs, the banking system, the exchange code, the financial market and insurance as well as land reforms.

Human development and social inclusion

The Government will, on the one hand, enhance the performance of the educational system and improve its employability. On the other hand, special attention will be given to policies relative to women, family and children as well as support for vulnerable social groups.

In addition, the reform of the social transfer system will focus on the targeting of beneficiaries. Promoting culture and strengthening health coverage will also be among the concerns of the social component of the next plan.

The realization of the ambitions of the regions

The aim is to ensure the development of decentralization, setting up the foundations of local democracy, the interconnection of regions and the improvement of their attractiveness.

Promoting green economy as a pillar of sustainable development

Efforts will be made to ensure the strengthening of a balanced and equitable land-use planning and the rationalization of the use of natural resources.

II. Measures of the Development Policy Support Program

The 2018 Development Policy Financing covers three pillars of economic policy aimed at removing barriers to investment, trade and entrepreneurship; moving towards a more efficient, sustainable and inclusive energy sector; and promoting greater economic and social inclusion.

The main objective of this support to development policies is, in particular, to promote more sustained growth and job creation that are driven by the private sector and to strengthen economic and social inclusion.

Pillar 1. Removing barriers to investment, trade and entrepreneurship

In order to accelerate reforms aimed at removing barriers to investment, improving the efficiency and transparency of trade related procedures and promoting entrepreneurship development, the Government of Tunisia has undertaken the following measures:

i) Simplification of investment entry authorizations

Under the provisions of the Investment Code, a "Unit of Management by Objectives" has been set up to develop a comprehensive mapping of the authorizations required for investment, on the basis of which, a roadmap will be developed in order to reduce the number of authorizations required for economic activities that have the greatest impact on employment and investment.

Thus, and in order to create a more transparent and efficient environment for stimulating economic growth, attracting local and foreign investment and fostering private sector participation and job creation by reducing market distortions and enhancing competition, the Government approved a decree that simplifies the investment access authorizations to certain economic activities. This is ensured through the development of a negative list specifically designating the reduced and exclusive list of economic activities that will remain subject to authorization. This decree also identifies all activities that will no longer be subject to authorization. The abolition of these authorizations will take effect within a maximum period of six months starting from the date of publication of the decree. This shall give the concerned ministries the possibility, if needed, to issue simplified TORs for the activities that require it within the above-mentioned period of six months.

The decree also defines the modalities for operationalizing the principle of "silence is deemed to signal acceptance" that has been provided for by the Investment Code and defines the tools and the detailed deadlines that will allow the implementation of this new principle.

Likewise, this decree provides for a maximum deadline of 60 days for the processing of authorization requests in all cases where no other deadline is provided. On the expiry of the said period of 60 days, the principle of "silence is deemed to signal acceptance" shall be applied.

ii) Digitization of import and export procedures

With a view to reducing the duration of stay of goods at ports, reducing export costs and improving the transparency of foreign trade procedures for the private sector; the Higher Council of Exports, held on January 4, 2018 adopted a resolution mandating the digitization of the main export and import procedures and the connection of all institutional actors involved in the trade sector to the Tunisia Trade Net platform by the end of 2018.

To this end, the Ministers of Trade, Transport and Finance together with foreign trade actors, like Tunisia Trade Net (TTN), have already started developing a list of the procedures that need to be digitized.

iii) Improving SMEs' access to public procurement

In order to improve SMEs' access to public procurement and increase the potential of the Tunisian e-procurement system (TUNEPS) in terms of budget execution and implementation of the public investment program and access to opportunities of public orders, the Government approved a decree mandating the use of TUNEPS for all public procurements that are made by Ministries, State-Owned Enterprises and Non-Administrative Public Enterprises.

This measure would improve the participation of SMEs in public procurement and promote greater competition and job creation opportunities. It would also improve private sector participation in disadvantaged regions through the online tool and guarantee more transparency and equality of treatment for all tenderers, and thus promote the efficiency of public procurement thanks to the reduction of transaction costs and to the rapidity of the process.

iv) Improving the legal and institutional framework for secured transactions

In order to strengthen the rights of creditors in terms of movable guarantees and to enable the creation of a register of movable assets and thereby improve access to credit, in particular for SMEs, the Government has approved a draft law on personal property security in compliance with the UNCITRAL Legislative Guide (Model Law) on Personal Property Security.

Indeed, the new law aims at establishing a legal and institutional framework for secured transactions that will simplify the legal processes governing the pledging of movable assets as collateral for loans, while providing for the conditions under which, after payment default, lenders shall be able to take over the assets.

After it is put in place, this modern secured transaction framework will particularly enable: (i) financing the working capital by providing the legal and institutional basis for supplier credit; (ii) Providing SMEs with bank loans by pledging their accounts receivable and movable property; and (iii) the substitution of certain public financing that is granted to public enterprises by bank loans secured by receivables. (iv) strengthening the credit security of banks and financial institutions in order to encourage them to further finance SMEs.

v) Improving the product offer of the SME Guarantee Fund

In order to improve SMEs' access to finance by attracting more private lenders to the guarantee fund of the Tunisian Guarantee Company (SOTUGAR) while optimizing its budgetary cost, the Ministry of Finance and SOTUGAR signed an agreement which will allow for improving the product offer presented by the Credit Guarantee Fund to SMEs, the bank clearing procedures, the risk management and the fund's governance.

This measure will expand the eligibility criteria for guarantees to cover all the financing needs of SMEs and strengthen the capacities to control the financial sustainability of the fund and the management of the budgetary risk.

Pillar 2: Shifting towards a more efficient, sustainable and inclusive energy sector

In order to reduce energy subsidies that represent a burden for the state budget due to the rise in international prices and the depreciation of the dinar; and in order to encourage and attract private investment, particularly in the sector of renewable energies, the Government has undertaken the following actions:

vi) Developing a Subsidy Reduction Policy Note

In order to reduce energy subsidies and improve the efficiency of the energy sector, the Government has prepared a concept note on energy subsidy reform policy.

This note aims at achieving a successful implementation of the subsidy reform that will allow the energy sector to rationalize costs, contain the deficit and create a budget space for a more inclusive growth. In this framework, and as a first step in the rationalization of electricity and gas subsidies, the Ministry of Energy, Mines and Renewable Energies has readjusted the prices of these products while preserving household purchasing power.

vii) Improvement of the commercial performance of the Tunisian Electricity and Gas Company (STEG)

In order to improve the commercial performance of the Tunisian Electricity and Gas Company (STEG) and enhance its financial sustainability and efficiency as a buyer of electricity from private renewable energy projects, the Board of Directors of STEG and the Minister of Energy, Mines and Renewable Energies have approved a commercial strategy for STEG aimed at reducing losses and improving its recovery capacity in compliance with the objectives of its 2016-2020 performance contract. This includes, in particular, improving the distribution networks in order to reduce technical losses, installing smart meters for all heavy consumers, and acquiring an improved commercial computer system to optimize recovery by the year 2019.

viii) Accelerating the implementation and increasing the size of renewable energy projects

In order to improve the security of electricity production and energy mix, the Government adopted on February 28, 2018 the decision to accelerate the implementation and increase the size of renewable energy projects that are part of the Renewable Energy Plan. This plan aims to reach the rate of 30% of the overall electricity shall be generated from renewable energies by 2030, and it is based on production by the private sector. To this end, the Ministry of Energy, Mines and Renewable Energies published on May 11, 2018 the call for pre-qualification of investors for the realization under concession of: (a) solar photovoltaic plants with a total capacity of approximately 500 MW; (b) wind power plants with a total capacity of approximately 500 MW.

Pillar 3: Promoting a larger economic and social inclusion

In order to strengthen the impact of macroeconomic and tax reforms on poor and vulnerable families and for the sake of a greater economic and social inclusion of these families, the Government has initiated a review of its approach to the targeting of social assistance programs in order to rationalize support and subsidies for needy families, particularly through:

ix) Setting up social safety nets

In order to modernize the legal framework and improve the targeting approach that would increase the impact and effectiveness of social safety net programs and control the budgetary cost of social safety net coverage, the Government approved and submitted to Parliament in November 2017 the Social Protection Draft Organic Law (Loi Orgqnique Amen Social), which establishes the principle of targeting of safety net programs.

Under this new law, the new targeting model and the modification of administrative support processes are essential for effective expansion of social safety nets.

Similarly, the Government has developed and discussed with the ministerial departments a first report on the targeting model, 'approximation of household means model'. The purpose of this technical report is to present approximation models of the standard of living of households (Proxy Means Test (PMT)) in Tunisia in order to identify beneficiaries of social assistance programs.

x) Establishing an interdepartmental working committee for the design of a child social protection program

In order to support the development of a cash transfer program and to optimize the coordination between the various institutional actors which targets the effectiveness of the fund transfer, the Minister of Social Affairs signed a ministerial Decree creating an interdepartmental working committee, which aims at designing a new social protection program with cash transfers and complementary services for poor and low-income households who have children aged 0 to 18 years old.

In the long term, the expected outcomes of this program include improvements in human development at the household level, including reduced levels of school drop-out and adherence to immunization schedules among targeted beneficiary households.

xi) <u>Improving access to microfinance</u>

In order to channel the resources of microfinance to the most vulnerable populations and micro-entrepreneurs, the Minister of Finance has issued a ministerial decree raising the ceiling of the amount of loans for microfinance.

This reform is likely, on the one hand, to improve access to microcredit for very small entrepreneurs, thus improving their ability to engage in income-generating activities and on the other hand, to preserve access to micro-finance for vulnerable groups, including women.

Thus, microfinance institutions will be able to provide additional and more substantial funding to support unemployed young graduates who plan to engage in activities requiring loans which amounts are higher than the current ceiling.

Mr. President,

The consistency of the reform actions provided for in this program is a proof of Tunisia's firm commitment to engage in a new process of development and construction that can anchor the spirit of democracy and ensure economic prosperity and social progress in compliance with the aspirations of the revolution.

The Financial technical assistance to this reform effort is necessary in order to face present and future challenges. The Tunisian Government is thus determined to implement, with the support of its partners, all the reforms planned under the framework of this program that is geared towards investment, competitiveness and economic inclusion in order to ensure economic and social recovery. For this purpose, the Tunisian government requests an appropriate financial support of the World Bank.

Zied Ladhari
Minister of Development, Investment
and International Cooperation

République Tunisienne

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

n° 2113 11 MAI 2018

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

Lettre de politique de développement

Programme d'appui budgétaire 2018 : Investissement, compétitivité et inclusion

Monsieur le Président du Groupe de la Banque Mondiale,

Forte d'une **démocratie naissante** couronnée tout récemment par l'organisation **des premières élections municipales libres et pluralistes**, la Tunisie aborde une phase décisive de sa transition économique avec la ferme volonté de renforcer ses acquis démocratiques et insuffler une nouvelle dynamique à l'activité économique.

Conscient de l'acuité des pressions et de la fragilité de la situation macroéconomique, le Gouvernement de l'Union Nationale s'est engagé à un **effort d'ajustement finement mesuré** pour rétablir la solidité des grands équilibres macroéconomiques et favoriser une croissance soutenable à moyen et long terme. De même, le Gouvernement s'attèle vivement à assurer un meilleur pilotage macroéconomique qui concilie la double dimension conjoncturelle et structurelle dans la gestion des affaires publiques.

Par ailleurs, il importe de souligner que la spécificité de l'année 2018 réside dans le fait que c'est une année charnière pour la concrétisation de la relance économique telle que prévue par le Plan de Développement. Cette relance économique est largement tributaire du progrès au niveau de la mise en œuvre des réformes économiques et sociales et, plus particulièrement, l'impact des mesures de politiques économiques adoptées pour améliorer l'environnement des affaires.

Démocratie naissante consolidée par l'organisation d'élections municipales libres, pluralistes et transparentes

Les élections municipales organisées le 6 mai 2018 marquent le parachèvement du processus de transition démocratique. Ces élections locales organisées pour la première fois depuis la révolution et supervisées par l'Instance Supérieure Indépendante pour les Elections sont de nature à asseoir les **fondements d'une bonne gouvernance locale** annoncée par la nouvelle constitution tunisienne.

Par ailleurs, l'adoption du **code des collectivités locales** par l'Assemblée des Représentants du Peuple est une consécration de la **démocratie locale** et la délégation de prérogatives importantes aux régions dans la gestion des affaires publiques locales. En effet, ce code consacre les principes de la libre administration des affaires locales, de l'autonomie administrative et financière et de la démocratie participative.

L'adoption de ce code constitue un jalon pour l'instauration graduelle de la décentralisation en tant que nouveau mode de gouvernance locale.

Parallèlement et dans l'objectif de consolider les bases de la bonne gouvernance, la transparence et la responsabilisation des acteurs, le Gouvernement s'attèle à parachever le cadre institutionnel notamment en accélérant la mise en place des instances constitutionnelles indépendantes à l'instar de l'instance de bonne gouvernance et de la lutte contre la corruption et de l'instance de développement durable et de la protection des droits des générations futures.

Concernant la **lutte contre la corruption**, le Gouvernement d'Union Nationale n'a cessé de réitérer son engagement irréversible à lutter contre ce fléau. Cet engagement est largement conforté par la mise en place d'un cadre juridique et institutionnel conformes aux standards internationaux se rapportant particulièrement au registre du commerce, aux suretés immobilières, à la lutte contre le blanchiment d'argent, à la protection des données individuelles, ...

De surcroit, il importe de noter les progrès remarquables dans la maîtrise **de la situation sécuritaire** grâce à la persévérance du Gouvernement dans l'éradication de la nébuleuse terroriste la mobilisation de moyens financiers exceptionnels et l'engagement des forces de sécurité ; En témoigne la levée des restrictions de voyage annoncée par les principaux partenaires et le retour massif des touristes grâce notamment à l'envergure des opérations menées par les institutions sécuritaire et militaire et la nouvelle stratégie sécuritaire qui se veut proactive, volontariste et anticipative.

Amélioration continue de l'environnement des affaires ... malgré une conjoncture difficile

Face à l'acuité des problématiques aussi bien structurelles que conjoncturelles, le Gouvernement a accordé une attention particulière à la mise en œuvre des réformes économiques majeures pour améliorer l'environnement des affaires et rendre le site tunisien plis attractif et plus compétitif.

Plus concrètement, l'année 2018 a été marquée par la mise en place des organes de gouvernance de la nouvelle loi d'investissement. Il s'agit de l'**Instance Tunisienne d'Investissement** qui sera l'interlocuteur unique et fonctionnera par la suite comme un « *one stop shop* » pour accompagner les investisseurs nationaux et étrangers et faciliter les formalités et procédures administratives. Ceci outre le démarrage des travaux du **Conseil Stratégique de l'Investissement** qui regroupe aussi bien les acteurs privés que publics dont le rôle principal est de promouvoir l'effort d'investissement privé et d'améliorer le climat des affaires à travers l'approbation de stratégies globales et sectorielles appropriées.

De surcroit, le Gouvernement s'est engagé à réduire d'une manière substantielle le nombre des autorisations liées à l'investissement afin de libérer le potentiel économique et de booster l'investissement privé. Une liste négative des activités économiques soumises à autorisation a été adoptée et ce en prenant en considération les spécificités des domaines et des activités liés aux ressources naturelles rares, la sécurité et défense... Le décret y afférent sera publié incessamment.

Concomitamment, et dans le cadre de l'accélération de la mise en œuvre des composantes de la **politique de transition énergétique**, un plan d'action pour l'accélération des projets de production d'électricité à partir des d'énergie renouvelables en Tunisie a été annoncé au mois de mars 2018. Les principaux axes d'orientation ce programme concernent le régime des concessions, le régime des autorisations, le régime d'autoproduction et le financement et la gouvernance du plan solaire.

La préparation très avancée du projet de la loi organique relative à **l'Economic Sociale et Solidaire** est de nature à renforcer le développement inclusif en Tunisie. Cette loi vise une meilleure inclusion économique et sociale et une contribution partagée dans la création des richesses et des emplois.

Ce souci d'inclusion économique et sociale a accéléré la création de l'observatoire **d'inclusion financière** au sein de la Banque Centrale de Tunisie en novembre 2017. la principale mission de cet observatoire est l'évaluation et le suivi de l'accès aux services financiers en Tunisie. Les travaux de cet observatoire seront consolidés, particulièrement, par le développement de la finance digitale et de la micro-assurance.

Par ailleurs, l'adoption de **la loi sur les startup** s'inscrit dans le cadre de la mise en œuvre de la stratégie digitale Tunisie 2020 visant à rendre la Tunisie un pôle régional attractif pour les entreprises émergentes. Cet objectif s'aligne avec les priorités nationales au titre de l'économie numérique et de l'impulsion de l'initiative des jeunes et des innovateurs.

Dans le même sillage, une attention particulière a été accordée au **développement des chaines de valeurs à plus haute valeur ajoutée** et à fort potentiel de création d'emplois dans les régions. Cette orientation reflète la volonté accrue de favoriser la synergie entre les investissements publics et/ou privés d'une part et d'assurer un appui technique plus efficace aux petites et moyennes entreprises d'autre part.

L'ensemble de ces réformes sont confortées par la restructuration du dispositif de **financement des petites et moyennes entreprises** à travers le développement du système de microfinance et le développement du capital investissement.

De surcroit, et dans le cadre de la promotion de l'approche du **partenariat public privé** et le lancement des projets structurants, une conférence de haut niveau portant sur les projets à réaliser en mode PPP est programmée pendant la deuxième quinzaine du mois de juin prochain.

Consolidation budgétaire et réformes fiscales incontournables

La loi des Finances 2018 a été marquée par **l'engagement manifeste de maitriser les dépenses publiques** dans un souci de **remettre les finances publiques sur une trajectoire soutenable.** L'objectif est de contenir le déficit budgétaire aux alentours de 4.9% du PIB.

Cette maitrise est assurée par la mise en application de la réforme de la fonction publique avec ses deux composantes le départ volontaire à la retraite et le départ volontaire négocié favorisant ainsi une diminution du nombre des fonctionnaires. Ceci est de nature à réduire le ratio de la masse salariale et de converger vers l'objectif de 12.4% prévu pour 2020.

Parallèlement, la loi des Finances 2018 table sur une réduction des subventions énergétiques via l'adoption d'ajustements trimestriels automatiques des prix des hydrocarbures à la pompe.

Côté recettes, l'objectif pour 2018 est de lutter contre la fraude fiscale avec l'élargissement de l'assiette fiscale pour une meilleure mobilisation des revenus budgétaires.

Politique monétaire prudente mais proactive

Conformément aux attributions de la Banque Centrale en matière de ciblage d'inflation, les autorités ont opté pour un resserrement de la politique monétaire à travers **l'élargissement du corridor** pour le porter de 50 à 200 points de base.

Par ailleurs, et face à la persistance des tensions inflationnistes, la Banque Centrale de Tunisie a relevé le taux directeur de 75 points de base début mars 2018.

Dans l'ensemble, les actions de la Banque Centrale de Tunisie ont été menées de façon **proactive** sur la base du profil de l'inflation à court et moyen terme afin de ramener l'inflation à moyen terme à des niveaux acceptables permettant **l'ancrage des anticipations des agents économiques.**

Inclusion sociale... de la nécessité d'adoption de réformes structurelles graduelles et coordonnées

Dans le cadre de la consécration d'une **approche participative de dialogue et de concertation**, le Gouvernement a procédé à la création du **Conseil National du Dialogue Social.** Ce conseil a pour mission d'organiser et gérer le dialogue social concernant les questions sociales et économiques d'intérêt commun pour les trois partenaires sociaux.

De surcroit, et afin de garantir un meilleur ciblage des transferts sociaux, les efforts se déploieront pour réviser les critères d'éligibilité et de pondération pour les programmes d'assistance sociale aux familles nécessiteuses. Le projet d'une « Banque de Données sur les familles nécessiteuses et à revenu limité » est en stade de finalisation afin d'instaurer un système d'information performant pour la gestion des programmes d'aides sociales avec des critères objectifs. La finalité étant l'élaboration d'un **Identifiant Social Unique** favorisant le basculement d'un système de subvention universelle vers un **ciblage des familles nécessiteuses.**

Quant à la **réforme des caisses de sécurité sociale**, la maitrise du déficit des caisses dans les années à venir est largement tributaire de la réforme paramétrique de la retraite qui se traduirait par une augmentation de l'âge de la retraite et une augmentation des cotisations. Toutefois, il y a lieu de souligner que des mesures additionnelles correctives sont envisageables afin d'assurer la viabilité financière des caisses.

L'objectif d'amélioration des conditions de vie dans les régions défavorisées du pays a exhorté le Gouvernement à développer une **stratégie d'inclusion financière** pour les groupes vulnérables et suivre de près l'état d'avancement des investissements publics en difficultés dans les domaines de l'infrastructure et des services collectifs.

Reprise modérée de l'activité économique

Les réalisations du premier trimestre de l'année 2018 confirment la reprise du rythme de croissance au niveau de quelques secteurs productifs notamment les industries mécaniques et électriques et le textile. En outre, une très bonne récolte des olives à huile combinée à une bonne performance du secteur touristique présagent d'une excellente année agricole et touristique.

Ainsi, **l'objectif de croissance pour l'ensemble de l'année 2018 serait de l'ordre de 2.4%** et de 3.3% en 2019.

Côté demande, l'année 2018 se caractériserait par des sources de croissance plus équilibrées avec une meilleure performance des exportations et de l'investissement particulièrement privé.

Au niveau des équilibres financiers, le déficit courant serait maitrisé aux alentours de 9.8% du PIB en dépit de l'acuité des pressions au niveau de la balance énergétique principalement. Toutefois, il est attendu que les pressions sur l'inflation perdureront durant le premier semestre 2018 avec un **léger desserrement** durant le dernier trimestre de l'année 2018.

Par ailleurs, il importe de noter que les besoins de financement extérieur pour l'année 2018 s'élèveront à près de 15% du PIB.

I. Politiques et perspectives de développement

Les orientations stratégiques et les politiques de développement à l'horizon 2020 exprimées dans le plan de développement stratégique 2016-2020 viennent concrétiser la nouvelle vision de la Tunisie et consacrer le nouveau modèle de développement qui réunit efficacité, inclusion et soutenabilité.

Les grandes orientations stratégiques et les priorités de l'action gouvernementale pour la période à venir ont été consolidées par le « Document de Carthage » signé par les principaux partis politiques et organisations nationales ; Les priorités de la prochaine étape s'articulent autour de la lutte contre le terrorisme, l'accélération du rythme de croissance, la lutte contre la corruption et la consécration des attributs de la bonne gouvernance, la préservation des équilibres financiers et la poursuite de la mise en œuvre de politiques sociales efficaces, l'élaboration d'une politique dédiée aux villes et aux collectivités locales et le renforcement de l'action du gouvernement et la mise en place de toutes les institutions de l'Etat.

Les axes stratégiques du plan de développent qui a été mis sous l'emblème du plan des réformes sont :

La consécration de la bonne gouvernance, la réforme de l'administration et la lutte contre la corruption

Pour ce faire, un système national d'intégrité sera mis en place et les principes de bonne gouvernance à l'échelle sectorielle et locale seront renforcés. Le Gouvernement veillera à promouvoir la production et la diffusion de l'information statistique conformément aux normes internationales et garantir **l'accès à l'information**.

De plus, les règles de la bonne gouvernance seront appliquées au niveau des établissements et entreprises publiques.

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

La transformation la Tunisie en un hub économique

L'objectif étant de diversifier le tissu économique et ce, pour assurer un fort potentiel d'exportation et de booster les créations d'emploi et ce, à travers la conception de politiques et stratégies sectorielles appropriées, l'amélioration de l'infrastructure et de la logistique, l'optimisation des ressources allouées au système national de la recherche et de l'innovation permettant ainsi l'amélioration de la productivité et la montée dans les chaines de valeur à l'échelle mondiale et la création d'un cadre propice à l'innovation et la créativité.

Par ailleurs, **l'économie numérique** sera une grande priorité du Gouvernement. Les efforts seront intensifiés en vue de la diffusion de la culture numérique et la numérisation des supports pédagogiques, la migration vers une administration électronique au service du citoyen et de l'entreprise, la mise en place du projet « Smart Tunisie » (off-shoring) dans le domaine numérique et le développement de l'infrastructure numérique.

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

Le développement humain et l'inclusion sociale

Le Gouvernement veillera, d'une part, à rehausser la performance du système éducatif et d'en améliorer l'employabilité. D'autre part, une attention particulière sera portée à la politique de la femme, de la famille et de l'enfance ainsi qu'au soutien des catégories sociales vulnérables.

En sus, **la réforme du système des transferts sociaux** sera axée sur le ciblage des bénéficiaires. La promotion de la culture et le renforcement de la couverture sanitaire seront aussi parmi les préoccupations du volet social du prochain plan.

La concrétisation des ambitions des régions

L'objectif étant d'assurer le développement de la **décentralisation**, la mise en place des fondements de la **démocratie locale**, l'interconnexion des régions et l'amélioration de leur **attractivité** en valorisant les potentialités régionales et en favorisant les fondements d'un développement économique local plus inclusif.

La promotion de l'économie verte comme pilier du développement durable

Cette vision stratégique prend en considération la vulnérabilité des ressources naturelles disponibles et les spécificités régionales d'une part et la nécessité de préserver l'environnement et favoriser une meilleure redistribution spatiale de la population et des activités d'autre part.

A cet effet, les efforts seront déployés afin de garantir le renforcement de **l'aménagement du territoire équilibré et équitable** et la rationalisation de l'utilisation des ressources naturelles et conserver les droits des générations futures.

II. Mesures du programme d'appui aux politiques de développement

Le programme d'appui budgétaire aux politiques de développement pour l'année 2018 couvre trois piliers de politique économique qui visent à lever les obstacles à l'investissement, au commerce et à l'entrepreneuriat, à s'orienter vers un secteur de l'énergie plus efficace, durable et inclusif, et à promouvoir une plus grande inclusion économique et sociale.

L'objectif principal de cet appui aux politiques de développement est notamment de promouvoir une croissance et une création d'emplois plus soutenues tirées par le secteur privé et de renforcer l'inclusion économique et sociale.

Pilier 1. Lever les obstacles à l'investissement, au commerce et à l'entrepreneuriat

Afin d'accélérer les réformes visant à éliminer les obstacles à l'entrée des investissements, à améliorer l'efficacité et la transparence des procédures commerciales et à promouvoir le développement de l'entreprenariat, le Gouvernement tunisien a entrepris les mesures suivantes :

i) Simplification des autorisations d'accès à l'investissement

En vertu de la loi de l'investissement, une «Unité de Gestion par Objectifs» a été mise en place afin de dresser une cartographie exhaustive des autorisations requises pour l'investissement, sur la base de laquelle, une feuille de route sera établie pour réduire les autorisations pour les activités économiques qui ont le plus d'impact sur l'emploi et l'investissement.

Ainsi et afin de créer un environnement plus transparent et efficace pour stimuler la croissance économique, attirer les investissements locaux et étrangers et favoriser la participation du secteur privé et la création d'emplois en réduisant les distorsions du marché et en améliorant la concurrence, le Gouvernement a approuvé un décret qui simplifie les autorisations d'entrée de l'investissement dans certaines activités économiques dans le cadre d'une liste négative désignant précisément la liste réduite et exclusive des activités économiques qui resteront soumises à autorisation. Ce décret identifie de même l'ensemble des activités qui ne seront plus soumises à autorisation. La suppression de ces autorisations prendra effet dans un délai maximal de six mois à compter de la date de publication du décret de manière à laisser aux ministères concernés la possibilité de sortir le cas échéant des cahiers de charges simplifiés pour les activités qui le requièrent et ce dans ledit délai de six mois.

Le décret défini également les modalités pour opérationnaliser le principe du « silence vaut consentement » qui a été introduit par la loi de l'investissement et définit le dispositif et les délais détaillés qui permettront de mettre en œuvre ce nouveau principe.

De même, ce décret introduit un délai maximal de traitement des demandes d'autorisation de soixante jours dans tous les cas où aucun un autre délai n'est prévu. A l'expiration dudit délai de soixante jours, le principe du « silence vaut autorisation » sera appliqué.

ii) <u>Numérisation des procédures d'importation et d'exportation</u>

Pour réduire le séjour des marchandises aux ports et les coûts à l'exportation et améliorer la transparence des procédures de commerce extérieur pour le secteur privé, le Conseil Supérieur des Exportations, tenu le 04 janvier 2018 a adopté une décision rendant obligatoire la numérisation des principales procédures d'exportation et d'importation et la connexion de tous les acteurs institutionnels impliqués dans le commerce à la plateforme Tunisie Trade Net d'ici fin 2018.

A cette fin, les ministères du Commerce, du Transport et des Finances et les acteurs concernés par le commerce extérieur à l'instar de TTN ont commencé par dresser une liste des procédures à numériser.

iii) <u>Amélioration de l'accès des PME aux marchés publics</u>

Afin de promouvoir la transparence vis-à-vis des opérateurs économiques, améliorer l'accès des PME aux marchés publics et augmenter le potentiel du système tunisien d'achats publics en ligne (TUNEPS) en termes d'exécution budgétaire et de mise en œuvre du programme d'investissement public et l'accès aux opportunités des commandes publiques, le Gouvernement a approuvé un décret rendant obligatoire l'utilisation du TUNEPS pour tous les achats publics effectués par les Ministères, les Etablissements Publics et les Etablissements Publiques Non Administratifs.

Cette mesure permettrait d'améliorer la participation des PME aux marchés publics et favoriser une plus grande concurrence et de nouvelles opportunités de création d'emplois, la participation du secteur privé dans les régions défavorisées grâce à l'outil en ligne et garantir une plus grande transparence et une égalité de traitement pour tous les soumissionnaires et de nature à promouvoir l'efficacité des marchés publics grâce à la réduction des coûts de transaction et de la rapidité.

iv) <u>Amélioration des sûretés mobilières</u>

Afin de renforcer les droits des créanciers en matière de garanties mobilières et en vue de permettre la création d'un registre des actifs mobiliers et ainsi améliorer l'accès au crédit, en particulier pour les PME, le Gouvernement a approuvé un projet de loi sur les sûretés mobilières, aligné sur le Guide Législatif du UNCITRAL (loi type) sur les sûretés mobilières.

En effet, la nouvelle loi vise à établir un cadre juridique et institutionnel pour les transactions sécurisées qui permettra de simplifier les processus juridiques régissant la mise en gage d'actifs mobiliers en garantie de prêts tout en prévoyant les conditions dans lesquelles, après défaillance, les prêteurs pourront reprendre les actifs.

Ce cadre de transactions sécurisées moderne, mise en place permettra notamment : (i) le financement du fonds de roulement en fournissant la base légale et institutionnelle pour le crédit des fournisseurs ; (ii) le prêt bancaire aux PME en mettant en gage leurs comptes débiteurs et les biens mobiliers ; et (iii) le remplacement pour certains financements publics d'entreprises publiques par des financements bancaires garantis par des créances. (iv) renforcer la sécurité des crédits des banques et les institutions financières de nature à les encourager à financer davantage les PME.

v) <u>Amélioration de l'offre du Fonds de Garantie pour les PME</u>

Afin d'améliorer l'accès au financement des PME en attirant davantage de prêteurs privés pour le fonds de la garantie de la Société Tunisienne de Garantie (SOTUGAR) tout en optimisant son coût budgétaire, le Ministère des Finances et la SOTUGAR ont signé une convention qui permettra d'améliorer l'offre de produits du Fonds de Garantie des Crédits aux PME, les procédures de compensation des banques, la gestion des risques et la gouvernance du fonds.

Cette mesure permettra d'élargir les critères d'éligibilité aux garanties pour couvrir l'ensemble des besoins de financement des PME et de renforcer le contrôle de la viabilité financière du fonds et la gestion du risque budgétaire.

<u>Pilier 2 : S'orienter vers un secteur de l'énergie, plus efficace, durable et inclusif</u>

Afin de réduire les subventions énergétiques pesantes sur le budget de l'Etat pour des raisons de hausse des prix internationaux et de dépréciation du dinar et inciter et attirer l'investissement privé, en particulier dans les énergies renouvelables, le Gouvernement a entrepris les actions suivantes :

vi) Note de cadrage de la politique des subventions énergétiques

Afin de réduire les subventions énergétiques et d'améliorer l'efficacité du secteur de l'énergie, le Gouvernement a élaboré une note de cadrage de la politique des réformes des subventions énergétiques. Cette note vise une mise en œuvre réussie de la réforme des subventions qui permettra au secteur de l'énergie à rationaliser les coûts, à contenir le déficit et à dégager un espace budgétaire pour une croissance plus inclusive. Dans ce cadre et comme première étape de la rationalisation des subventions à l'électricité et au gaz, le Ministère de l'Energie, des Mines et des Energies Renouvelables a réajusté les prix de ces produits tout en préservant le pouvoir d'achat des ménages.

vii) Amélioration des performances commerciales de la STEG

Afin d'améliorer les performances commerciales de la Société Tunisienne de l'Electricité et de Gaz (STEG) et renforcer sa viabilité financière et son efficacité en tant qu'acheteur d'électricité issue de projets privés d'énergie renouvelable, le Conseil d'Administration de la STEG et le Ministre de l'Énergie, des Mines et des Energies Renouvelables ont approuvé une stratégie commerciale pour la STEG qui vise à réduire les pertes et améliorer sa capacité de recouvrement conformément aux objectifs de son contrat de performance 2016-2020, notamment en ce qui concerne l'amélioration des réseaux de distribution pour réduire les pertes techniques, l'installation de compteurs intelligents pour tous les gros consommateurs et l'acquisition d'un système informatique commercial amélioré pour optimiser le recouvrement d'ici 2019.

viii) Accélération et augmentation de la taille des projets d'énergies renouvelables

Afin d'améliorer la sécurité de la production électrique et le mix énergétique, le Gouvernement a adopté le 28 Février 2018 la décision d'accélérer la mise en œuvre des projets d'énergies renouvelables et d'en augmenter la capacité et la taille de ces projets et ce dans le cadre du Plan des Energies Renouvelables. Ce Plan a pour objectif d'atteindre 30 % d'électricité générée par les énergies renouvelables à l'horizon 2030 et provenant essentiellement du secteur privé. Dans ce cadre, le Ministère de l'énergie, des mines et des énergies renouvelables a lancé le 11 Mai 2018 un appel à pré-qualification pour la réalisation en concession de centrales photovoltaïques pour une puissance totale de 500 MW de et de centrales éoliennes pour une puissance totalede 500 MW.

Pilier 3 : Promouvoir une plus grande inclusion économique et sociale

Pour renforcer l'impact des réformes macro-économiques et fiscales sur les familles pauvres et vulnérables et pour une plus grande inclusion économique et sociale de ces familles, le Gouvernement a déclenché la revue de son approche de ciblage des programmes d'assistance sociale afin de rationaliser les appuis et les subventions aux familles nécessiteuses et ce à travers notamment :

Mise en place des filets sociaux

Afin de moderniser le cadre juridique et améliorer l'approche du ciblage qui permettrait d'accroitre l'impact et l'efficacité des programmes de filets sociaux, maitriser le coût budgétaire de la couverture des filets de protection sociale, le Gouvernement a approuvé et transmis au Parlement en Novembre 2017 le projet de Loi Amen (Loi Sécurité) qui établit le principe du ciblage des programmes de filet de sécurité.

Selon cette nouvelle loi, le nouveau modèle de ciblage et la modification des processus administratifs de soutien sont essentiels pour une expansion efficace des filets de sécurité sociale.

De même, le Gouvernement a élaboré et discuté avec les départements ministériels un premier rapport sur le modèle de ciblage 'modèle d'approximation des moyens des ménages ». L'objectif de ce rapport technique est de présenter des modèles d'approximation du niveau de vie des ménages (Proxy Means Test (PMT)) en Tunisie pour identifier les bénéficiaires des programmes d'assistance sociale.

ix) **Mise en place d'un comité de travail interministériel pour la conception d'un programme de protection sociale pour l'enfance**

Afin de soutenir le développement d'un programme de transferts monétaires et d'optimiser la coordination entre les différents intervenants institutionnels qui viseraient l'efficacité du programme de transfert de fonds, le Ministre des Affaires Sociales a signé un arrêté ministériel créant un comité de travail interministériel dont l'objectif est de concevoir un nouveau programme de protection sociale avec des transferts monétaires et des services complémentaires pour les ménages pauvres et à faibles revenus avec des enfants de 0 à 18 ans.

A long terme, les résultats attendus de ce programme comprennent des améliorations en termes de développement humain au niveau des ménages, y compris, des niveaux réduits d'abandon scolaire et un respect des calendriers de vaccination parmi les ménages bénéficiaires ciblés.

x) **Amélioration de l'accès à la micro-finance**

Afin de canaliser les ressources de la micro-finance vers les populations les plus vulnérables et les micro-entrepreneurs, le Ministre des Finances a émis un arrêté ministériel portant relèvement du plafond du montant des prêts pour la micro-finance.

Cette réforme est de nature, d'une part à améliorer l'accès au microcrédit pour les très petits entrepreneurs, améliorant leur capacité à se lancer dans des activités génératrices de revenus et d''autre part de préserver l'accès à la micro-finance pour les groupes vulnérables, y compris les femmes.

Ainsi, les institutions de micro-finance seront en mesure de fournir un financement supplémentaire et plus consistant pour appuyer les jeunes diplômés sans emploi qui comptent engager des activités nécessitent des prêts plus importants que le plafond actuel.

Monsieur le Président,

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

L'assistance technique et financière à cet effort de réforme s'avère nécessaire pour faire face aux défis présents et futurs. Le Gouvernement tunisien est ainsi résolu à mettre en œuvre avec l'appui de ses partenaires, toutes les réformes prévues dans le cadre de ce programme orienté vers l'investissement, la compétitivité et l'inclusion économique afin d'assurer de la relance économique et sollicite la Banque Mondiale pour un appui financier approprié.

Yours faithfully,

Zied Ladhari

Ministre du Développement, de l'Investissement

et de la Coopération Internationale

12

ANNEX 3: FUND RELATIONS

Press Release No. 18/104 March 26, 2018
IMF Executive Board Completes Second Review under the Extended Fund Facility (EFF) Arrangement for Tunisia

On March 23, 2018, the Executive Board of the International Monetary Fund (IMF) completed the second review of Tunisia's economic reform program supported by an arrangement under the Extended Fund Facility (EFF). The completion of the review allows the authorities to draw an amount equivalent to SDR 176.7824 million (about US$257.3 million), bringing total disbursements under the arrangement to the equivalent of SDR 631.3661 million (about US$919 million).

In completing the review, the Executive Board approved the authorities' request for moving towards quarterly reviews from the current semi-annual schedule. Overall disbursements available throughout the program remain unchanged. The Board also approved the authorities' request for waivers of non-observance of end of December performance criteria on net international reserves, net domestic assets, the primary fiscal deficit, and current primary spending; and the non-observance of the continuous performance criterion on imposing or intensifying restrictions on the making of payments and transfers for current international transactions. It also granted approval for the retention of an exchange restriction barring trade credit for certain non-essential imports until December 31, 2018.

The four-year EFF arrangement in the amount of SDR 2.045625 billion (about US$2.98 billion, 375 percent of Tunisia's quota) was approved by the Executive Board on May 20, 2016 (see Press Release No. 16/238). The government's reform program supported by the EFF aims at reducing macroeconomic vulnerabilities, ensuring adequate social protection, and fostering private sector-led, job-creating growth. Priorities include growth-friendly and socially-conscious fiscal consolidation to stabilize public debt below 73 percent of GDP by 2020 while raising investment and social spending, reversing the recent trend of accelerating inflation, and continued exchange rate flexibility to support exports and strengthen international reserve coverage. Structural reforms supported under the arrangement focus on improving governance, the business climate, fiscal institutions, and the financial sector.

Following the Executive Board discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, made the following statement:

"Tunisia has experienced a modest recovery in 2017, but continues to face elevated macroeconomic vulnerabilities, and unemployment remains high. Debt has continued to increase, inflation has accelerated, and international reserve cover is now less than three months of imports. Decisive implementation of the policies under the Fund-supported program is necessary to sustain macroeconomic stability.

"The authorities have begun to address these challenges through a deficit-reducing budget for 2018, monetary policy tightening, and a renewed commitment to a flexible exchange rate. Structural reforms have started to improve governance, strengthen the business environment, modernize the civil service and pensions, and restructure public banks.

“Successful fiscal adjustment will require strong policy implementation. It will be critical to increase tax revenue in an equitable manner and reign in current spending to reduce debt and increase investment and social expenditure. The 2018 priorities are to strengthen tax collection, implement the voluntary separations for civil servants, not grant new wage increases unless growth surprises on the upside, and enact quarterly fuel price hikes. It will be as important to distribute the adjustment burden equitably across society and protect the vulnerable. Public-private partnerships should only proceed with adequate legal and regulatory frameworks.

“The Central Bank of Tunisia has demonstrated its commitment to low inflation through a widening of the interest corridor followed by a strong policy rate increase. Further hikes will be needed to move real interest rates into positive territory unless inflation quickly subsides.

“Building on the real exchange rate depreciation in 2017, exchange rate flexibility will remain critical to correct the remaining overvaluation of the real exchange rate, improve the current account deficit, and rebuild reserves. This will require adherence to the FX intervention budget and more competitive FX auctions.

“The authorities have increased near-term financing for social security. This should be followed by equitable and sustainable pension reforms. Finalizing the database of vulnerable households, which is critical for the targeting of social assistance, will help preserve the social contract.

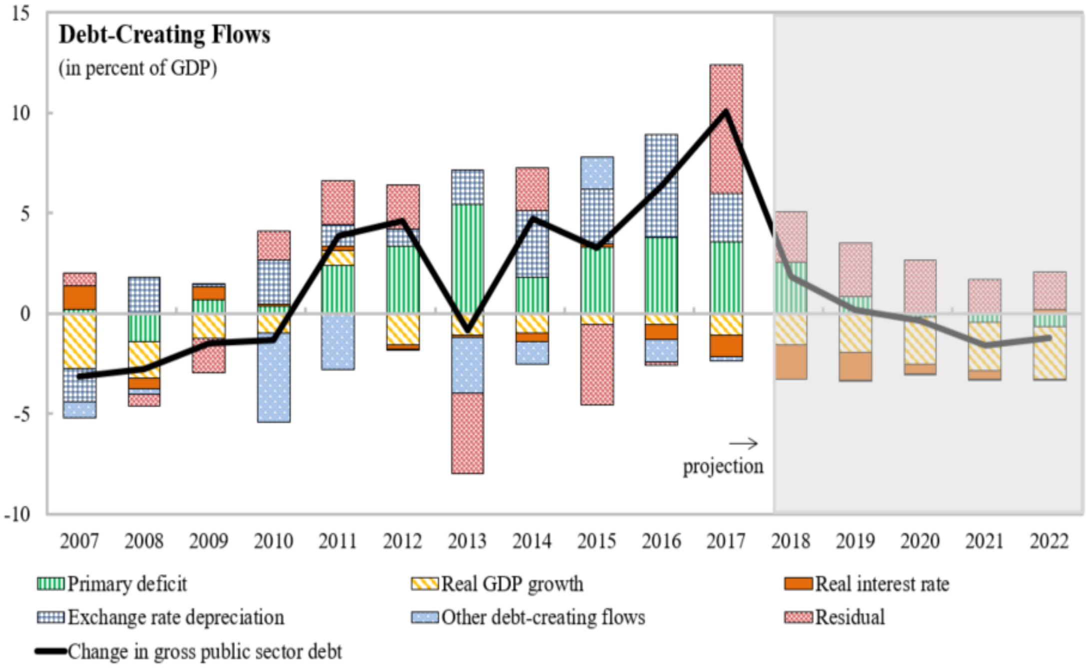
“The authorities have made considerable progress on structural reforms. They established the High Anti-Corruption Authority and are building institutions in support of the investment code, including the one-stop shop. The legislation to facilitate the reduction of NPL portfolios will help public bank restructuring. Ongoing enhancements to the AML/CFT regime will address Tunisia’s deficiencies in this area.

“Significantly improved program implementation, supported by quarterly reviews, and the continued support of the donor community for Tunisia’s reform efforts will be critical in the time ahead.”

ANNEX 4: PUBLIC DEBT SUSTAINABILITY ANALYSIS

Tunisia's fragile macroeconomic situation coupled with exogenous shocks has contributed to its debt-to-GDP breaching the 70 percent emerging markets debt burden benchmark. At an estimated 71.3 percent end-2017, debt-to-GDP increased by 24.4 percentage points since 2013. This rapid rise in debt was mainly driven by primary deficits (averaging 3.6 percent of GDP) and the dinar's devaluation amidst a context of slowing real growth to an average of 1.7 percent over 2013-2017 compared to a 3.1 percent average over 2007-2012 (Figure 1). Gross financing needs correspondingly rose to 10.8 percent of GDP (29.9 percent of revenues) in 2017.

Figure 1. Decomposition of Debt-Creating Flows, 2007-2



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

Tunisia's debt profile is predominantly external, in foreign currency, and long-term exposing Tunisia to currency risk albeit mitigated refinancing risk. Reversing a declining external debt trend before the revolution, Tunisia's external debt rose from 51 percent end-2011 to 80 percent end-2017 on account of exchange rate depreciation and larger twin deficits. With respect to the currency composition of public debt, while the share of domestic debt has been inching up in recent years to 33 percent 2017, the bulk of Tunisia's debt portfolio is denominated in foreign currency [half of which in Euros]. Tunisia's debt stock is almost exclusively medium and long-term. Despite the long-term nature of the debt and recent monetary policy tightening, Tunisia's effective nominal interest rate remains low and relatively stable (4.1 percent for 2017 vs. 4.2 percent 2014-2016 average) given the concessional nature of the foreign currency debt portfolio owed to multilateral and bilateral creditors and mainly guaranteed Eurobond issuances.[40] The effective nominal interest rate for domestic debt rose to 6.6 percent for 2017 compared to a 6.3 percent average for 2014-2016.

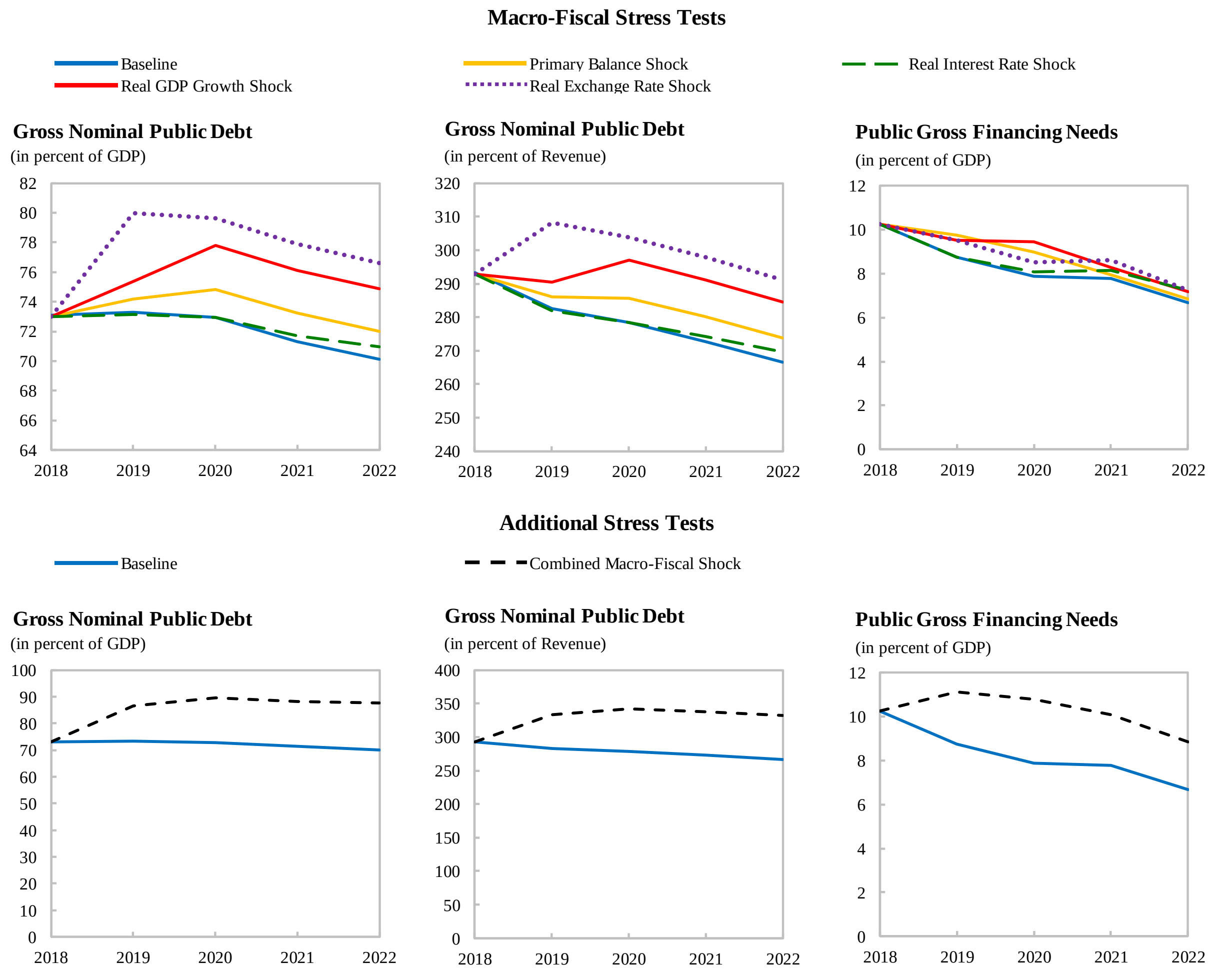
[40] Tunisia has issued two non-guaranteed Eurobonds: a US$ 1 billion in January 2015 and € 850 million in February 2017.

Tunisia's debt to GDP is projected to taper to 70 percent by 2022 under the baseline framework of prudent fiscal policy and a rebound in growth in the medium term. Debt to GDP is expected to peak at 73.3 percent in 2019 and improve thereafter. This baseline path assumes an improvement in the primary balance from a deficit of 3.6 percent in 2017 to a surplus of 0.9 percent of GDP in 2022 coupled with a recovery in real growth to 4 percent by 2022. Gross financing needs are forecasted at 6.7 percent of GDP by 2022 compared to 10.8 percent in 2017, supported by Tunisia's long-term debt profile and average effective interest rate of 4.0 percent over 2018-2022.

Tunisia's debt is likely to be sustainable under the baseline scenario although vulnerabilities are important. First, the extent of fiscal adjustment projected is significant. The political economy of implementing related measures may face opposition – particularly for more sensitive planned measures such as reform of energy subsidies, containing the wage bill, and reducing risks from SOEs - and derail the debt path. Second, recovery in growth – which includes structural reforms and assumptions about increased investment and recovery of the tourism sector - is dependent on confidence in Tunisia and domestic and regional stability which can be unexpected. This confidence is also important towards investor sentiment as Tunisia plans to issue more non-guaranteed Eurobonds. Third, Tunisia's debt profile exceeds upper warning signals for the external financing requirement, public debt held by non-residents, and public debt in foreign currency making it prone to an exchange rate shock.

Shock scenarios attest to the potential risks to debt sustainability largely stemming from shocks to the exchange rate, real GDP, primary balance and realization of contingent liabilities. Tunisia's debt to GDP is already above the 70 percent emerging market threshold. Standard stress tests and alternative scenarios run point to an increase in debt to GDP up to 90 percent depending on the shock scenario, while trending to a sustainable path in the medium term. An alternative scenario on the realization of contingent liabilities of 30 percent of estimated credit risk (from guarantees, on-lending, and Treasury loans to SOEs which totaled 14 percent of GDP in 2016) would pose the largest spike in gross financing needs in 2019.

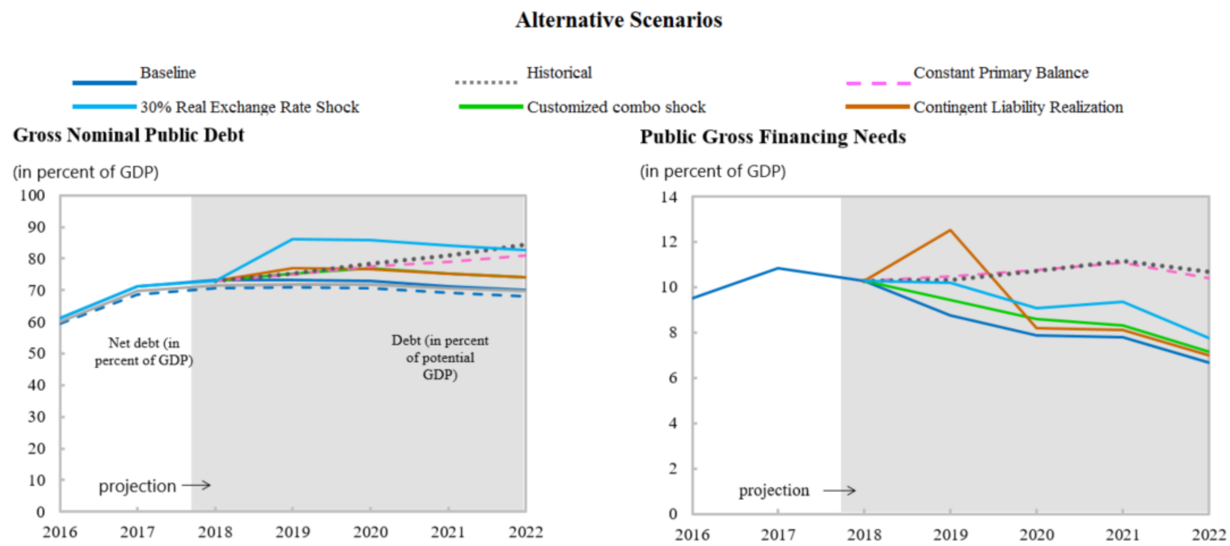
Figure 2. Debt and Gross Financing Needs under Baseline and Standard Stress Tests[41]



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

[41] The stress tests above are composed of the following: (1) Primary balance shock: Minimum shock equivalent to baseline minus half of the 10-year historical standard deviation. There is an increase in interest rates of 25bp for every 1 percent of GDP worsening in the primary balance; (2) Real GDP growth shock: Real GDP growth is reduced by 1 standard deviation for 2 consecutive years; revenue-to-GDP ratio remains the same as in the baseline; level of non-interest expenditures is the same as in the baseline; deterioration in primary balance lead to higher interest rate (see above); decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth); (3) Real interest rate shock: Interest rate increases by difference between average real interest rate level over projection and maximum real historical level; (4) Real exchange rate shock: Maximum historical movement of the exchange rate; pass-through to inflation with default elasticity of 0.25 for emerging markets; and (5) Combination macro-fiscal shock: Shock size and duration based on the above underlying shocks incorporating worst outcomes for each indicator.

Figure 3. Debt and Gross Financing Needs under Baseline and Alternative Scenarios[2/]



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

[2/] The alternative scenarios are composed of the following: (1) Real exchange rate shock: 30 percent real exchange rate shock in 2019 coupled with pass through effect to inflation (this is different than the standard exchange rate shock presented in Figure 3 which is based on the maximum historical depreciation); (2) Customized combination shock: One standard deviation negative real growth shock for 2019 and 2020 coupled with 30 percent of fiscal adjustment not undertaken, 25 bps interest rate shock and pass through to inflation (0.25 percent inflation decline for each 1 standard deviation reduction in real growth); and (3) Contingent liability realization: 30 percent realization of the value of estimated credit risk (14 percent of 2016 GDP (guarantees, on-lending, and Treasury loans to SOEs) on expenditures and corresponding interest rate shock of 25 bps for each 1 percent GDP deterioration in the primary balance for 2019.

Table 1: Debt Burden Ratios (Baseline Scenario)

(%)	Average 2006-2012	2013	2014	2015	2016	2017	2018p	2019p	2020p	2021p	2022p
Total public debt-to-GDP	43.6	46.8	51.6	54.8	61.2	71.3	73.1	73.3	72.9	71.3	70.1
Total public debt-to-Revenue	187.7	186.8	197.6	232.8	268.3	294.5	293.3	282.5	278.4	272.8	266.5
Debt service-to-GDP	6.4	5.9	6.0	5.4	5.8	7.2	7.7	7.9	8.1	8.2	7.3
Debt service-to-Revenue	27.9	23.4	23.1	23.1	25.2	29.9	30.8	30.5	30.8	31.4	27.8

Gross financing needs-to-GDP	7.2	11.3	7.9	8.8	9.5	10.8	10.3	8.7	7.9	7.8	6.7
Gross financing needs-to-revenue	31.2	45.2	30.1	37.2	41.8	44.8	41.2	33.7	30.1	29.8	25.4

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

Table 2: Key Assumptions Underlying Alternative Scenarios

	2018	2019	2020	2021	2022
Baseline					
Real GDP growth (in percent)	2.4	2.9	3.4	3.6	4.0
Inflation (in percent)	6.4	5.6	4.5	4.3	3.8
Primary Balance (in percent of GDP)	-2.6	-0.8	0.2	0.4	0.6
Effective Interest Rate (in percent)	4.0	3.8	3.9	3.8	4.2
Primary Balance Shock					
Real GDP growth (in percent)	2.4	2.9	3.4	3.6	4.0
Inflation (in percent)	6.4	5.6	4.5	4.3	3.8
Primary Balance (in percent of GDP)	-2.6	-1.8	-0.8	0.4	0.6
Effective Interest Rate (in percent)	4.0	3.8	4.0	3.9	4.3
Real GDP Growth Shock					
Real GDP growth (in percent)	2.4	1.1	1.6	3.6	4.0
Inflation (in percent)	6.4	5.2	4.1	4.3	3.8
Primary Balance (in percent of GDP)	-2.6	-1.4	-1.0	0.4	0.6
Effective Interest Rate (in percent)	4.0	3.8	4.0	3.9	4.3
Real Interest Rate Shock					
Real GDP growth (in percent)	2.4	2.9	3.4	3.6	4.0
Inflation (in percent)	6.4	5.6	4.5	4.3	3.8
Primary Balance (in percent of GDP)	-2.6	-0.8	0.2	0.4	0.6
Effective Interest Rate (in percent)	4.0	3.8	4.2	4.4	5.0
Real Exchange Rate Shock					
Real GDP growth (in percent)	2.4	2.9	3.4	3.6	4.0
Inflation (in percent)	6.4	10.6	4.5	4.3	3.8
Primary Balance (in percent of GDP)	-2.6	-0.8	0.2	0.4	0.6
Effective Interest Rate (in percent)	4.0	4.2	3.9	3.8	4.2
Combined shock					
Real GDP growth (in percent)	2.4	1.1	1.6	3.6	4.0
Inflation (in percent)	6.4	5.2	4.1	4.3	3.8
Primary Balance (in percent of GDP)	-2.6	-1.8	-1.0	0.4	0.6
Effective Interest Rate (in percent)	4.0	4.2	4.2	4.4	5.0
Alternative: Customized combo shock					
Real GDP growth (in percent)	2.4	1.1	1.6	3.6	4.0
Inflation (in percent)	6.4	5.2	4.1	4.3	3.8
Primary Balance (in percent of GDP)	-2.6	-1.4	-0.1	0.4	0.6
Effective Interest Rate (in percent)	4.0	3.8	4.0	3.9	4.3
Alternative: Contingent Liability Realization					
Real GDP growth (in percent)	2.4	2.9	3.4	3.6	4.0
Inflation (in percent)	6.4	5.6	4.5	4.3	3.8
Primary Balance (in percent of GDP)	-2.6	-4.6	0.2	0.4	0.6
Effective Interest Rate (in percent)	4.0	3.8	4.1	4.0	4.4
Alternative: 30% Real Exchange Rate Shock					
Real GDP growth (in percent)	2.4	2.9	3.4	3.6	4.0
Inflation (in percent)	6.4	15.6	4.5	4.3	3.8
Primary Balance (in percent of GDP)	-2.6	-0.8	0.2	0.4	0.6
Effective Interest Rate (in percent)	4.0	4.7	3.8	3.8	4.1

ANNEX 5: POVERTY AND SOCIAL IMPACT ANALYSIS

1. Introduction

This poverty and social impact analysis (PSIA) evaluates the proposed reform of electricity and gas subsidies by simulating their impact on household welfare. Using a household consumption survey and an input-output table, the analysis estimates direct effects via changes in prices of subsidized products and indirect effects via changes in prices of non-subsidized products. The PSIA is organized as follows. The next section explains the analytical framework and baseline data. Section 3 describes the results of the simulations. Section 4 illustrates the impact of proposed mitigation measures and Section 5 concludes.

2. Data and methodology

To estimate the direct and indirect effects of benefits to households from subsidized gas and electricity, the analysis uses a subsample of the *Enquête National sur le Budget, la Consommation et le Niveau de Vie des ménages* (ENBCNV 2015) collected by the *Institut National de la Statistique* (INS). The ENBCNV asked respondents how much they spent on electricity and gas (low pressure gas for cooking). But since the gas and electricity bill comes together, respondents typically replied by showing the cost of the two items together; it was very difficult to disentangle the two. Therefore, this exercise assumes they are one item and that the variation in the electricity price affects the consumption of electricity and gas[42].

Table 1: Average Electricity Prices (mill/kWh) and year on year price variation (%)

		Price variation			Percentage price variation		
	April 2018	May 2018*	2019	2020	May 2018*	2019	2020
Average variation	228	244	261	280	7.1%	7.1%	7.1%
Social tariff (0-100 kWh/month)	138	144	151	157	4.4%	4.4%	4.4%
101-200 kWh/month	194	214	235	258	9.9%	9.9%	9.9%
201-300 kWh/month or >2 kVA	221	237	254	272	7.2%	7.2%	7.2%
301-500 kWh/month	244	259	275	292	6.2%	6.2%	6.2%
>500 kWh/month	319	330	343	355	3.7%	3.7%	3.7%

*Price adjustment enacted in May and effective July 1, 2018. Source: Société Tunisienne de l'Electricité et du Gaz

[42] When checking the different cost of the two items from other sources, the cost of electricity accounts normally for more than 90 percent of the energy bill. It may therefore be not so inaccurate to consider the electricity price variation as representative of the whole price shock.

Regarding the methodology to assess access and incidence of electricity subsidies, the standard benefit incidence analysis framework is applied (Demery, 2000)[43] and the software SUBSIM[44] is used to calculate the welfare impact. Table 1 shows the proposed electricity price changes over a period of 4 years. This takes into account the possibility that the government continues the adjustment over 2019, that is beyond the currently discussed price adjustment.

Below we will present 2019 results as outcomes of the already planned reform and 2020 results that represent the hypothetical scenario of the reform continuation. On average - changes vary by consumed quantities as reported in Table 1- price increased in May 2018 by 7.1 percent (effective July 1, 2018); if the reform will be implemented also beyond 2019, there will also be an increase by 7.1 percent in 2020. Compared to the pre-reform, the electricity price in 2020 will be, on average, 23 percent higher.

The total welfare impact simulation of this price shock is obtained by summing the direct and indirect price effects. The direct effect is the welfare loss caused by the increase of the electricity price on electricity consumption. The indirect effect is the general equilibrium effect, or in other words the impact of electricity price variation on the consumption of all other items.

The direct loss, L_{D_i}, is computed by multiplying the household budget share of a specific item, $s_{ij}C_i$, by the price variation (percentage change in price), Δp_j, and the price elasticity, ε_{p_j}:

$$L_{D_i} = s_{ij}C_i * \Delta p_j * \left(1+\varepsilon_{p_j}\right), \quad \text{for} \quad -1 < \varepsilon_{p_j} \leq 0. \tag{1}$$

The indirect loss, L_{I_j}, uses the budget share of all the other items purchased by the household, $\left(1-s_{ij}\right)C_i$, and multiplies it by the price variation, a pass-through coefficient, β_j estimated using an Input-Output matrix and the cross price elasticity, ε_{p_k}:

$$L_{I_i} = \left(1-s_{ij}\right)C_i * \Delta p_j * \beta_j * \left(1+\varepsilon_{p_k}\right), \quad \text{for} \quad 0 < \beta_j \leq 1. \tag{2}$$

The Input-Output (I/O) records the ways economic sectors trade with one another as well as produce for consumption and investment. The I/O data required for this purpose are extracted from the 2015 social accounting matrix provided by the INS and adjusted to make them comparable with the household budget data. The elasticity is provided by a recent study on energy and fuel subsidies reform in Middle East and North Africa's

[43] Demery, L. (2000). *Benefit incidence: A practitioner's guide*. World Bank, Washington DC. http://documents.worldbank.org/curated/en/2000/07/6573903/benefit-incidence-practitioners-guide.

[44] http://www.subsim.org/

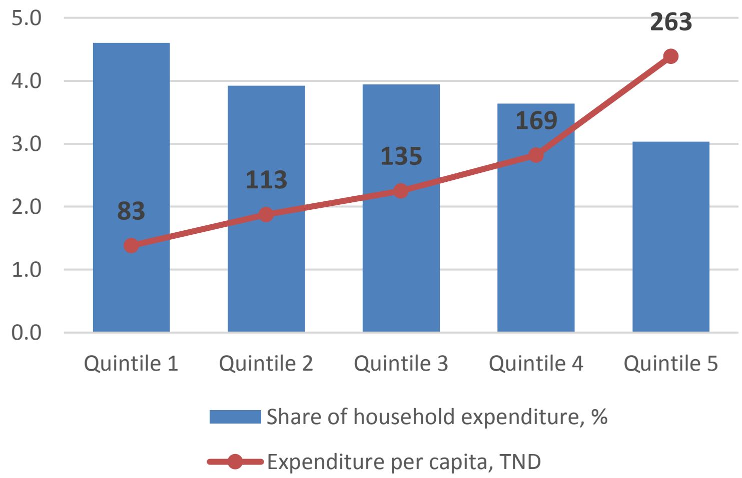
countries (Verme and Araar, 2017)[45] , its value is estimated to be around -0.5. The uncertainty around this parameter should be borne in mind when interpreting the results below.

Using (1) and (2) this PSIA simulates two different steps of the reform: May 2018 and subsequent years. For May 2018, we assume price elasticity equal to 0. In this first phase of the reform, electricity demand is completely inelastic and consumers cannot substitute electricity, bearing the full cost of the price change. In the short run it describes rather well consumers' behavior *vis-à-vis* a sudden shock. In the long run, on the other hand, consumers tend to adjust their consumption shifting to less expensive products, elasticity is therefore assumed to be -0.5.

3. Poverty Impact

Figure 1 shows the share of electricity and gas expenditures on total household expenditures. Poorer households spend on electricity and gas a slightly larger fraction of their total budget than richer. While the bottom 20 percent of the population spends about 4.5 percent of its budget on electricity and gas, central quintiles (2nd and 3rd) spend around 4 percent and 4th and 5th spend 3.5 and 3 percent, respectively. Overall, this simple calculation already shows that the subsidy can achieve only a modest progressivity.

Figure 1. Electricity and gas consumption share (%) and per capita consumption, by quintiles



Source: Authors' calculations based on ENBCNV 2015

Table 2 and Table 3 show respectively the average loss in Tunisian Dinars (TND) per capita for May 2018 and following years by quintiles and the loss as share of total expenditures. According to simulations, the welfare losses for the bottom 40 percent after May 2018 are around 0.6-0.7 percent of household expenditures within one year (between TND 9-14 per capita per year). It would average 1.3 percent of expenditures

45 Verme, Paolo; Araar, Abdelkrim. 2017. *The Quest for Subsidies Reforms in the Middle East and North Africa Region*: A *Microsimulation Approach to Policy Making*. Natural Resource Management and Policy; Cham, Switzerland: Springer. © World Bank. https://openknowledge.worldbank.org/handle/10986/25783"

within 1 year (between TND 19 and 28 per capita per year) and about 2 percent in two years (between TND 30 and 40 per capita per year), if the reform is prolonged to 2020 (between TND 30 and 40 per capita per year).

Table 2. Loss per capita by quintile, TND per year

	May 2018*	2019	2020
Quintile 1	9.46	19.59	30.38
Quintile 2	13.40	27.73	43.02
Quintile 3	16.75	34.68	53.79
Quintile 4	21.62	44.77	69.44
Quintile 5	36.34	75.24	116.70

*Price adjustment enacted in May and effective July 1, 2018. Source: Authors' calculations based on ENBCNV 2015

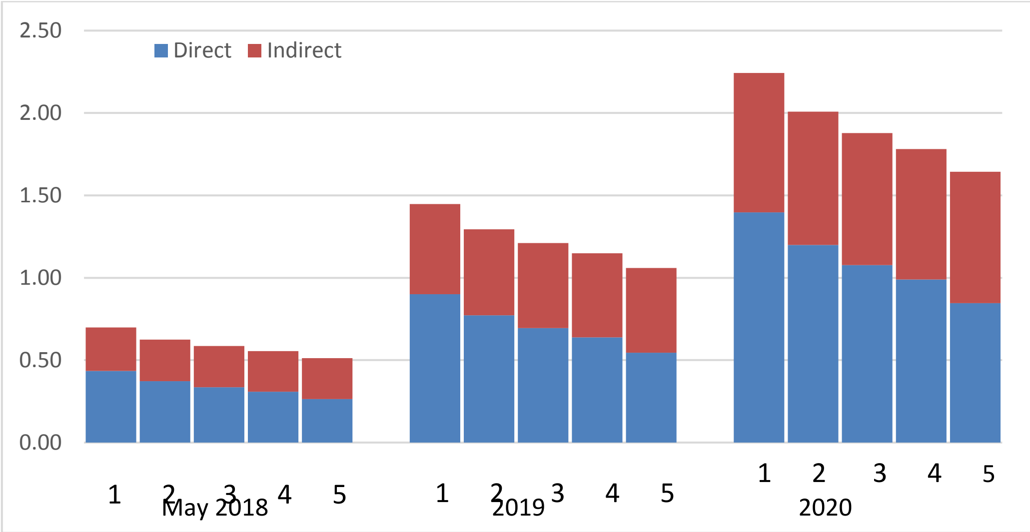
Table 3. Loss per capita by quintile, as % of total per capita consumption

	May 2018*	2019	2020
Quintile 1	0.70	1.45	2.24
Quintile 2	0.63	1.29	2.01
Quintile 3	0.59	1.21	1.88
Quintile 4	0.55	1.15	1.78
Quintile 5	0.51	1.06	1.64

*Price adjustment enacted in May and effective July 1, 2018. Source: Authors' calculations based on ENBCNV 2015

Regarding direct and indirect effect, Figure 2 shows that the impact of indirect loss is lower than the direct one and except for the May 2018 (as there are different price increase for various electricity consumption groups), the indirect effect tends to be around 30 percent of the total effect.

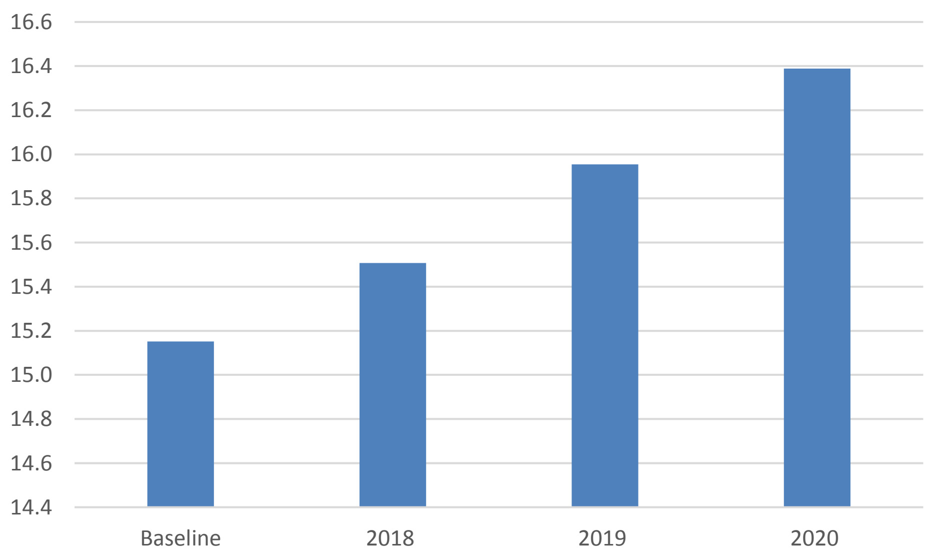
Figure 2: Direct and indirect losses over household expenditure, by quintile and years



Source: Authors' calculations based on a subsample of ENBCNV 2015

We extend the work presented in Tables 2 and 3 and Figure 2 to look more closely at both poverty and more detailed distributional patterns of the impact of reducing subsidies. To do this, we re-compute household consumption by subtracting the estimated losses and compute national (Figure 3) post-reform poverty rates. To complement these findings, we also calculated the cumulative distribution functions of consumption per capita (Figure 5) for the baseline, for 2020 scenario. In this figure, curves that lie to the left of another have lower welfare overall and more poverty.

Figure 3: Poverty rate change at national level



Source: Authors' calculations based on a subsample of ENBCNV 2015

Poverty (Figure 3) increases only by 0.4 percentage points after May 2018, but due to prices adjustment and increased energy bill, after one year, poverty is estimated to grow by 0.8 percentage points and after 2 years by 1.2 percentage points.

4. Compensatory policies

The reduction in electricity subsidies has, although marginal, an impact on poverty, by increasing the number of people falling below the poverty line and the degree of poverty severity of those already poor. Compensatory policies can be considered to moderate these negative effects. In this section we simulate a compensation mechanism that targets the poorest strata of the population and is able to compensate the incurred loss.

Social safety net (SSN) programs in Tunisia currently comprise non-contributory social assistance programs for poor households through unconditional cash transfers (UCT) and free health cards. Benefits are provided through the National Assistance to Needy Families Program, Program National d'Aide Aux Familles Nécessiteuses (PNAFN), managed by the Ministry of Social Affairs (MOSA). Households received a cash transfer of TND 150 per month in 2015, accounting for approximately 25 percent of the poverty line used to determine eligibility, which is TND 585 (approximately US$1.25 per day).

We simulate three compensatory measures that make use of existing social protection mechanisms and postulate either an increase in transfers only or an increase in coverage. One caveat of these measures simulation is that it assumes effective targeting of cash transfers by selecting the poorest households. In order to make the simulation a bit more realistic, we added 20 percent overhead (loss-coverage) to take into account the overhead costs of expansion and the costs associated with leakages and mis-targeting correction.

Compensatory measure 1 (announced in January and in effect since April, 2018)
= increased PNAFN transfer (+20% or +30 TND per month) to those already eligible

Compensatory measure 2 (announced in January and in effect since April, 2018)
= Compensatory measure 1 + 20% of minimum pension extra to those receiving a pension and belonging to Quintile 1 or Quintile 2

Compensatory measure 3 = Compensatory measure 2 + 180 dinars per person to those eligible if targeting is improved

Table 4: Compensation costs, in real March 2018 terms

Type of compensation	Cost, TND	Administrative costs, TND	Total cost, TND	Total cost, USD
Baseline (post shock)	0	0	0	0
Compensatory measure 1	96,907,925	19,381,585	116,289,510	48,861,138
Compensatory measure 2	194,644,503	38,928,901	233,573,403	98,140,085
Compensatory measure 3	815,172,792	163,034,559	978,207,350	411,011,492

Source: Authors' calculations based on a subsample of ENBCNV 2015

Table 4 illustrates the amount transferred to households (column 1), the overheads cost (column 2) and the total cost (column 3 in TND and column 4 in USD) associated with expanding the program to the poorest households in Tunisia. Depending on the number of measures undertaken, the program can cost between US$48 to US$411 million per year. These cash transfers are more effective in tackling poverty than un-targeted subsidies *if* the targeting mechanism can better identify the poor.

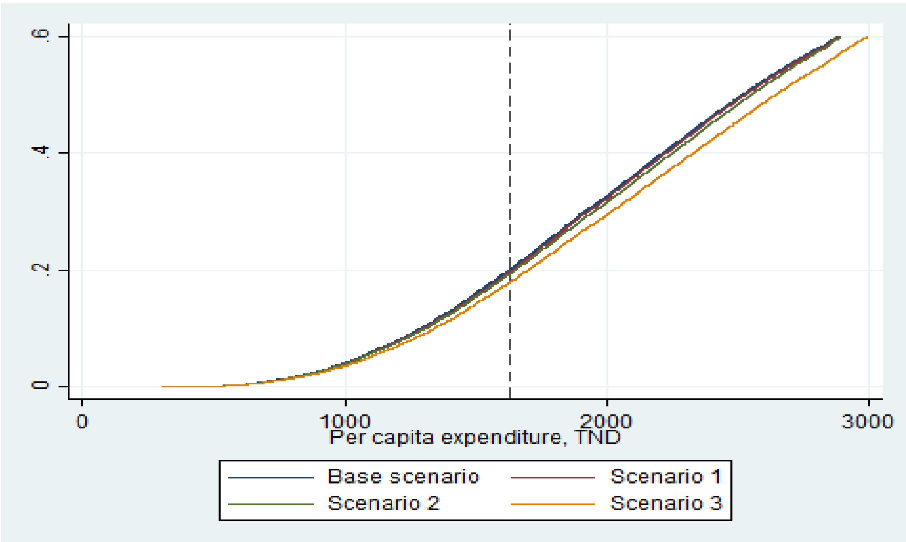
Table 5: Poverty impact

	Poverty rate	Poverty gap
2015	15.138	3.422
2018		
Baseline (post shock)	15.494	3.508
Measure #1	15.209	3.424
Measure #2	14.891	3.363
Measure #3	13.845	3.103
2019		
Baseline (post shock)	15.942	3.604
Measure #1	15.645	3.518
Measure #2	15.316	3.454
Measure #3	14.239	3.188
2020		
Baseline (post shock)	16.376	3.710
Measure #1	16.074	3.622
Measure #2	15.735	3.556
Measure #3	14.633	3.283

Source: Authors' calculations based on a subsample of ENBCNV 2015

In Table 5, we show the simulated poverty rates and the poverty gaps after compensations. Under various scenarios, only scenario 3 can have a significant impact in reducing the distance of the poorest from the poverty line (poverty gap indicator) and on the overall poverty rate.

Figure 5: Bottom 40 percent in 2020: compensation measures and post-shock distributions



Source: Authors' calculations based on a subsample of ENBCNV 2015

In Figure 5, we show the distribution of household income for the distributions in 2020 (after prices increases) and under our three scenarios. Only in the scenario 3, the compensation mechanisms shift the distribution to the right – meaning that households are getting better off and are less likely to be below the poverty line. The more the program coverage is increased, the larger is the welfare impact as shown by the movements rightward of the cumulative distributions.

5. Conclusions

As part of broader policy intervention to adjust fiscal imbalances, the Tunisian government is undertaking a progressive reduction of electricity and gas subsidies. Untargeted subsidies – while easy to implement – are often regressive and expensive. In this note, we examine the poverty consequences of the electricity and gas subsidy reduction, simulating the direct and indirect effects on household expenditures.

In general, electricity price increases that result from subsidy reductions are expected to trigger a generalized increase in all other prices. Essentially, such increases can potentially affect the price of every item produced in the country. The combined effect can augment the loss in the purchasing power of Tunisian household.

Simulations show that households' losses can average after one year about 1 percent of total households' expenditures (around TND 38 per capita per year) and, if the reform is prolonged to 2020, around 1.9 percent after two years (around TND 60 per capita per year). Regarding poverty, the simulations indicate an increase in the poverty rate of about 0.8 percentage points after one year (from the national poverty rate of 15.2 percent) and of about 1.2 percentage points in two years.

Comparing the three simulations of compensatory measures we conclude that only scenario 3, which has improved targeting over current programs, has a significant impact in reducing the distance of the poorest from the poverty line (poverty gap indicator) and on the overall poverty rate. The prior actions under pillar 3 of this operation make this scenario more realistic over time – and within the window of future adjustments in energy prices.

ANNEX 6: ENVIRONMENTAL AND POVERTY/SOCIAL IMPACT ANALYSIS

Prior actions	Significant positive or negative environment effects (yes/no/to be determined)	Significant poverty, social or distributional effects positive or negative (yes/no/to be determined)
Pillar 1. Removing barriers to investment, trade and entrepreneurship		
Prior action #1: To stimulate private investment and building on an exhaustive mapping of investment authorizations, the Borrower has approved a reduced list of economic activities that remain subject to authorizations, and defined the deadlines and procedures for processing authorization requests of economic activities under said reduced list, pursuant to Borrower's Governmental Decree No. 2018-417, dated May 11, 2018 and published in the Official Gazette No. 38 dated May 11, 2018.	Adverse environmental impacts are not expected conditional upon the implementation of mitigation measures per current environmental legal and regulatory framework. The approval of the decree would lead to an increase of investments across economic sectors. However, the current environmental and regulatory framework and institutional capacity, if applied adequately, is believed to be sufficient to ensure that necessary mitigation measures are in place.	Adverse poverty and social impacts are not expected. It is expected that there will be higher job creation stemming from more openness, higher firm creation and investment.
Prior action #2: To reduce the time and cost to export and improve the transparency of trade procedures, the Borrower has made mandatory the digitization of all export and import procedures and the connection of all institutional stakeholders involved in trade to the Tunisia Trade Net platform by the end of 2018, pursuant to Borrower's Conseil Supérieur des Exportations Decision dated January 4, 2018.	Adverse environmental effects are not expected conditional upon the implementation of mitigation measures per current environmental legal and regulatory framework. The measure may result in the increase of the volume of transport (road and maritime). However, the current environmental and regulatory framework and institutional capacity is believed to be sufficient to ensure that necessary mitigation measures are in place.	Adverse poverty and social impacts are not expected. More efficient port procedures could translate into lower prices of imported goods. Higher import penetration could lead to job loss while increased exports will increase national income and could create more jobs.
Prior action #3: To improve SMEs access to markets, the Borrower has made e-procurement (through TUNEPS) mandatory for public procurement pursuant to the Borrower's Governmental Decree No. 2018-416 dated May 11, 2018, published in the Official Gazette No. 38, dated May 11, 2018, modifying and complementing Decree No. 2014-1039 dated March 13, 2014 regulating public procurement.	Adverse environmental impacts are not expected.	Adverse poverty and social impacts are not expected. It is expected that there will be higher job creation and income for SMEs.

Prior action #4: To improve SMEs access to finance, the Borrower's Council of Ministers has approved and transmitted to Parliament the draft Law on Secured Transactions aligned with the UNCITRAL Legislative Guide on Secured Transactions, pursuant to Borrower's Council of Ministers' decision dated May 7, 2018 and Transmittal Letter to the Parliament dated May 16, 2018.	Adverse environmental impacts are not expected conditional upon the implementation of mitigation measures per current environmental legal and regulatory framework.	Adverse poverty and social impacts are not expected. It is expected that there will be higher job creation and income for SMEs.
Prior Action #5: To improve SMEs access to finance, the Borrower has improved the financial products offered by the SME Credit Guarantee Fund, its operating and payment procedures and its risk management framework, pursuant to an agreement (Convention) between the Borrower's Ministry of Finance and the Société Tunisienne de Garantie dated April 18, 2018.	Adverse environmental impacts are not expected conditional upon the implementation of mitigation measures per current environmental legal and regulatory framework.	Adverse poverty and social impacts are not expected. It is expected that there will be higher job creation and income for SMEs.
Pillar 2. Moving towards a more efficient, sustainable and inclusive energy sector		
Prior action #6: To contain the electricity and gas subsidies, the Borrower has approved an electricity and gas tariff adjustment in line with its Energy Subsidy Reduction Policy Note, pursuant to the Borrower's Minister of Energy, Mines and Renewable Energy's Letter addressed to STEG dated May 10, 2018.	Positive environmental effects are expected. Tariff adjustment and subsidy rationalization will lead to a reduction in demand and consumption of electricity and gas, ultimately resulting in positive environmental effects through reduction in emission of air pollutants and lower GHG emissions. Risks of greater use of biomass and cheaper energy alternatives by poorer households as a result of the electricity and tariff adjustment may have negative effects such as forest degradation, air pollution and environmental health problems. This will however be mitigated by recent significant increase in cash transfers and their planned future expansion.	Adverse poverty and social impacts are not expected. On the firm side, the reform will reduce price distortions and improve market functioning and contribute to greater efficiency and productivity. On the household side, the effects of the rise in utility prices on poorer households are mitigated by recent significant increase in cash transfers and their planned future expansion.

Prior action #7: To improve the performance of the STEG through actionable performance contracts, and greater accountability, the Executive Board of STEG and the Borrower's Minister of Energy, Mines and Renewable Energy have approved a commercial action plan for STEG to reduce losses and improve collection of bills, in line with the objectives of STEG's performance contract for 2016-2020, pursuant to Borrower's Minister of Energy, Mines and Renewable Energy's Letter dated April 18, 2018.	Positive environmental effects are expected through the reduction in the technical and commercial losses of the electricity and gas utility.	Adverse poverty and social impacts are not expected.
Prior action #8: To improve the energy mix, the Borrower has adopted a decision to scale up and accelerate the implementation of Tunisia's Renewables Plan through private sector owned renewable energy capacity, pursuant to Borrower's Council of Minister's Decision dated February 28, 2018.	Positive environmental effects are expected. An improved enabling environment for investments in renewable energy will lead to the accrual of environmental benefits emanating from the reduction in emission of air pollutants and the associated decrease in health risks and the decrease in GHG emissions.	Adverse poverty and social impacts are not expected. Higher investment in renewable through private projects would be accompanied with job creation and could lower the cost and price of electricity and improve its reliability (especially at peak demand) leading to positive benefits to consumers.
Pillar 3. Promoting greater economic and social inclusion		
Prior action #9: To establish the foundation for a well targeted and fiscally sound expansion of the coverage of social safety nets, the Borrower's Council of Ministers: (i) has approved and transmitted to Parliament the Social Protection Draft Organic Law (Loi Organique Amen Social) which, in particular, establishes the principle of targeting of safety net programs; and (ii) has approved the new targeting model, including key implementation procedures, all pursuant to Borrower's (i) Council of Ministers' Decision dated September 13, 2017 and transmittal letter to Parliament dated December 26, 2017, and (ii) Council of Ministers' Decision dated May 7, 2018, respectively.	Adverse environmental impacts are not expected. Positive environmental impacts are expected to the extent that cash transfers to poor households contribute to reducing their demand for biomass.	Positive poverty and social impacts are expected through the targeted expansion of the social safety nets to poor and vulnerable households.

Prior Action #10: To protect the poor and promote their human capital, the Minister of Social Affairs has established an inter-ministerial working group to prepare the design (including objectives, interventions, budget and key institutional arrangements) of a new social protection program with cash transfers and complementary services to poor households with children 0 to 18 years old, pursuant to the Borrower's Minister of Social Affairs' Decision dated April 2, 2018.	Adverse environmental impacts are not expected. Positive environmental impacts are expected provided cash transfers to poor households contribute to reducing their demand for biomass.	Positive poverty and social impacts are expected through the increased in benefits of the cash transfer program to poor and vulnerable households.
Prior action #11: To improve access to micro-credit for income generating activities, the Borrower's Minister of Finance has raised the loan amount ceiling for micro-credits, pursuant to the Borrower's Minister of Finance's Arrêté, dated April 13, 2018 and published in the Official Gazette No. 31, dated April 17, 2018.	Adverse environmental impacts are not expected. Microfinance institutions as financial intermediaries need to adhere to sound environmental and social management practices and screen the sub-projects they finance to ensure that they are prepared and implemented in accordance with sound environmental and social management practices and national law. The environmental and social safeguards management framework developed under the World Bank-financed Tunisia Micro, Small and Medium Enterprise Development Project could be used as reference in this regard. Improved access to credit for micro-entrepreneurs, will likely reduce the pressure on fragile natural resources by local populations by providing them with the means to diversify their livelihoods.	Positive poverty and social impacts are expected through improved access to microcredit for income generating activities, particularly for youth, women and in lagging regions.

ANNEX 7: POLITICAL ECONOMY FILTER

I. The Political Economy Filter

There is now overwhelming evidence that many technically sound development reforms and projects can fail to achieve their objectives because of institutional and political constraints (WDR 2017).[46] Political economy (PE) unpacks how power and resources are distributed and contested between interest groups and the implications for the feasibility of a reform or project (DFID 2009).[47] Indeed, the post-Arab Spring Maghreb region faces a number of complex institutional and political challenges. Moreover, World Bank task teams often lack the granular knowledge of how political economy specifically matters for a given policy reform, sector, operation or tier of governance; and how to respond best. As a prominent IEG report puts it: "*an understanding of the political economy is critical for the organization's [Bank's] effectiveness… [it] broadens the World Bank's operational considerations beyond technical analysis and takes into account the significance of power relations, vested interests, and social divisions*" (IEG, 2016).[48]

In response, the innovative Maghreb Governance and Political Economy (PE) Filter was operationalized with a two-fold development objective: (1) to improve the effectiveness of the Maghreb development portfolio – in selected operations in Tunisia and Morocco – by identifying and helping address governance and political economy constraints and opportunities; and (2) to strengthen World Bank knowledge of how political economy issues shape policy reform prospects, project implementation and development results. The Filter work is organized in two main components: (a) providing hands-on operational support to strategic, selected operations; and (b) deepening and sharing knowledge on relevant issues.

II. Tailoring the DPF to the PE of Reform: What Was Done and How It Made a Difference

The Filter was imbedded in the preparation of the proposed DPF. Specifically, in this proposed DPF, the Filter work focused on four key questions:

- How could the DPF team think and work differently to address PE constraints?
- How could the DPF team balance ambitious reforms with political feasibility?
- How could the DPF team better address PE risks related to selected prior actions?
- How could the Bank mobilize complementary instruments to help unblock reform bottlenecks?

As such, the following key steps were undertaken: (a) commissioned political economy expertise to better understand the underlying PE of economic reform; (b) used political economy knowledge and a PE specialist to attend key meetings on policy dialogue, to help strategically frame and focus the discussions; (c) commissioned political economy analysis to identify PE risks and responses related to some of the most "difficult" DPF prior actions;

---

[46] World Bank. 2017. *World Development Report 2017: Governance and the Law*. Washington, DC: World Bank.

[47] DFID (2009). Political Economy Analysis How to Note. UK DFID: London. Weblink: https://www.odi.org/sites/odi.org.uk/files/odi-assets/events-documents/3797.pdf

[48] IEG (2016). The Role of Political Economy Analysis in Development Policy Operations. WBG IEG: Washington DC. Weblink: http://ieg.worldbankgroup.org/sites/default/files/Data/reports/lp_poleconanalysis_0716.pdf

and (d) developed complementary TA programs to address political economy barriers identified in the previous and current DPF. Each of these areas is briefly described below.

a. Better Understanding the Constraints: The Political Economy of Economic Reform in Tunisia

From a political economy perspective, the DPF operations in Tunisia need to be understood in the context of the country's ambitious, yet incomplete and fragile, transition, which presents opportunities and barriers to socio-economic reform. A review was undertaken, and the principal PE barriers to economic reform identified by the Filter are summarized here:

- **There are difficulties in terms of state capacity, accountability and effectiveness in designing and implementing the complex economic reform process in the new *multi-stakeholder* environment** which is very different to the command-and-control way reforms were made in the pre-Revolution period;
- **This is limited coordination at an inter-ministerial/departmental level, coupled with limited coordination between the administration and the legislature (parliament),** which can all contribute to reform uptake and reform implementation bottlenecks;
- **Inter-ministerial vision and communication could be strengthened.** Current weakness result in limited understanding and implementation of the reforms among public servants and the population;
- **There is a limited capacity of the government to convince, communicate and negotiate effectively with external stakeholders** to achieve new elite bargains and societal agreements to advance the reforms;
- **There are significant pockets of resistance to certain reforms as the result of**: a) some actors, see themselves as the "losers" of the reform, blocking reform implementation (such as the trade unions, social groups or business, administrative and political elites); and/or, b) a lack of effective strategy and organization on the part of pro-reform actors or reform "winners". This is exacerbated by the spectre of deteriorating security conditions; and,
- **The country is currently characterized by fractious and fluid coalition politics.** This coalition relies primarily on two main political parties as well as relying on a formal role of the powerful trade union the UGTT (as per the Carthage Pact of 2014). The main consequences of this are: (a) frequent ministerial reshuffles, often driven by political patronage rather than technical merit, which results in some shifting reform orientations and disjointed reform processes; (b) spending, such as on public-sector recruitments, as a way to buy social peace and political consensus; and, (c) short-term time horizons which can dis-incentivize taking on complex, slow-burning and painful reforms.

b. Framing and Filtering the High-Level Economic Reform Dialogue

The DPF operations are a key instrument of high-level policy dialogue and policy reform between the World Bank, the Tunisian Government and other development partners. The Filter helped inform the strategic content, framing and design of the DPF by addressing the following questions:

(a) How can the DPF balance the need for ambitious reforms with the imperative to maintain political and social stability (and avoid any backsliding in the transition)? (b) How could the DPF present a package that includes a good balance between "painful" reforms (i.e. costs) with benefits to help appease the perceived reform losers and to gain wider political and social support?
(c) Which reforms, given the economic situation and local realities, should be prioritized and included in the DPF?

The following key design changes were made as a direct result of the Filter work:

- **It was judged that the benefits outweigh the costs of proceeding with a DPF this FY rather than postponing it until greater reform implementation progress is made**. This is because: (a) a worsening external fiscal situation in the short-term (aggravated by the absence of DPF financing) risks fueling social and political instability and causing regressive steps in the transition (a risk that is particularly concerning given the geo-political significance of the Arab Spring success story); (b) it is judged to be wise to incentivize meaningful, albeit incremental, reforms rather than removing all external financing incentives for reform; and, (c) the costs of reform inaction in terms of greater economic and social instability outweighs the costs of taking meaningful and calibrated reform steps to tackle the deteriorated and very fragile economic situation.
- **The DPF is a stand-alone, as opposed to programmatic, operation embedded in a continued and larger dialogue on reform implementation for the following reasons**: (a) it lessens the risk of drift in timeliness and relevance that characterized past programmatic operations due to political and security shocks occurring during its effectiveness; and, (b) it lessens the risk of the impact of the national elections (2019), which may be disruptive and may change some policy orientations.
- **In order to start building pro-reform coalitions around the prior actions, there has been constant dialogue and validation of the urgency of reforms with the government**. Moreover, in order to strengthen action by the counterpart, the issues and urgency have been framed in key economic terms e.g. rising inflation and its detrimental impact on the poor and vulnerable, unsustainable external position and dwindling reserves which increases the risk of disorderly adjustment and lead to disorderly adjustment which will shoot up inflation and unemployment, lack of investment job creation, etc.
- **The mixture of prior actions has been developed based on striking a balance between different imperatives**: (a) ambition and political realism/risk; (b) focusing on concrete reform actions to tackle the economic situation; and (c) introducing new reform areas and continuing/building on reform areas addressed in the DPF of 2017.
- **To improve impact, reduce resistance to the package and broaden support for the package, the DPF combines a combination of reforms to compensate for potentially negative impacts of the economic reform process.** For example, the pillar of inclusion is designed to provide counteracting benefits, especially for poor and vulnerable groups, given the deteriorated macroeconomic situation and rising inflation, and the potential negative impact of needed reforms. Similarly, electricity and gas tariff adjustments occur in a broader context of steps taken to improve sector efficiency and lay the ground for a successful renewable energy program.

- **In terms of feasibility, the reforms were filtered to prioritize a set of critical reforms that could be achievable in the short term.** This meant that some key reforms were excluded, due to their medium-term feasibility, but such reforms were then identified for support through other Bank instruments, such as TA or investment lending.

c. Addressing the PE of Specific Prior Actions

In addition to above, the Filter also examined the PE risks and responses in relation to three priority prior actions: (1) investment simplification; (2) energy tariff adjustments; and (3) new social safety net law and SSN targeting model. Three prior actions were selected based on discussions with the task team, and based on the knowledge base and sensitivity related to the actions. The key questions asked were: what key PE issues, opportunities and risks are associated with the prior action in question? Who may resist the adoption and implementation of the action? How could the action be modified to reduce such risks? What complementary measures could be taken to address the identified issues? As a result of this analysis, the prior action was modified and refined.

d. Designing Complementary Initiatives to Address the PE of Reform Implementation

Finally, the Filter helped identify targeted TA and investment lending that could complement the DPF and address the political economy of implementation. Some of the key actions include the following:

- **To address the PE of broader SOE reform and public-sector reform, a program of adaptive leadership and strategic communications has been established.** Implemented with the Tunisian Ministry of Major Reforms, this program focuses on three main outcomes: (a) improved governmental capacity to communicate, negotiate and build stakeholder support for reforms, including with the powerful unions; (b) improved governmental reform implementation capacity, coordination and follow-up; and (c) increased knowledge of, and integration of, adaptive and politically astute approaches to reform implementation.
- **To support the implementation and follow-up of the energy subsidy reform, a strategic TA has been developed.** This will include further problem-focused PE analysis, as well as the development and implementation of a stakeholder negotiation and communication strategy with the public and key stakeholders such as industries and unions.
- **To address the PE of implementation of the Public Investment Management Agenda (from DPF 2017), a set of activities have been put in place.** This includes: (a) activities to strengthen the selection and monitoring of public investments through new operational guidelines and training of implementers; (b) implementation of the data bank to screen and improve investments; and (3) change management strategies to reduce resistance amongst administrators and contractors to modernization of the system.