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Report No. \_\_\_\_\_

**INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT**

**INTERNATIONAL DEVELOPMENT ASSOCIATION**

**INTERNATIONAL FINANCE CORPORATION**

**MULTILATERAL INVESTMENT GUARANTEE AGENCY**

**COUNTRY PARTNERSHIP FRAMEWORK**

**FOR**

**REPUBLIC OF TUNISIA**

**FOR THE PERIOD FY2016-2020**

**October 19, 2015**

**DRAFT FOR DISCUSSION**

**Maghreb Department  
Middle East and North Africa Region**

**The International Finance Corporation**

**The Multilateral Investment Guarantee Agency**

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## I. COUNTRY CONTEXT AND DEVELOPMENT AGENDA

### A. SOCIOPOLITICAL CONTEXT

1. ***Tunisia is the only country to emerge from the “Arab Spring” with a democratic state.*** Awarding the Nobel Peace Prize to the Tunisian National Dialogue Quartet in October 2015 “for its decisive contribution to the building of a pluralistic democracy in Tunisia in the wake of the country’s 2011 revolution” recognizes the role that civil society has played in helping the country move from authoritarian rule to an open democratic political process. The Quartet, made up of the General Labor Union (UGTT); the Confederation of Industry, Trade and Handicrafts (UTICA); the Human Rights League; and the Order of Lawyers is a manifestation of a robust civil society which was already crucial for achieving the political changes wrought in Tunisia in 2011,. The fact that these groups were able to work together—despite their differences, shows the resilience of the Tunisian people. The Nobel Peace Prize also represents an important acknowledgement of the progress the country has made in the past four and a half years, since protestors overthrew longtime dictator Ben Ali (see Box 1). The adoption of a new Constitution in early 2014, followed by orderly presidential and parliamentary elections in late 2014, constitutes the most visible achievement of this transition.

2. ***The January 2011 revolution was fueled by consensus that Tunisia’s post-independence social contract had fundamental shortcomings triggering widespread anger and frustration over lack of social and political inclusion, governance and corruption issues, mounting unemployment and the rising cost of living.*** Nearly five years after the revolution, Tunisia’s new social contract has yet to fully materialize and thus there is an increasing feeling among stakeholders that key revolution “demands” have yet to be fulfilled. As such, Government has made this one of its top priorities to foster the enabling environment for a fairer economic model with opportunities for all to materialize.

3. ***Today, Tunisia is still in transition. The democratic transition is far from being complete and the Government faces a tricky balancing act in maintaining security and social stability while preserving hard-won personal freedoms.*** The two highly destabilizing terrorist attacks perpetrated in March and June 2015 along with smaller incidents are significant setbacks. Not only did these claim lives, but they also inflicted significant shocks on Tunisia’s already fragile economy. Political chaos in neighboring Libya has allowed Islamist militants to grow both in strength and in number. Tunisia has now become the largest source of foreign fighters joining the Islamic State and other extremist groups in Syria and Iraq, with an estimated 3,000 Tunisians (most of them men under 30) fighting for the Islamic State of Iraq and the Levant (ISIL). The June 2015 Sousse terrorist attack triggered heated parliamentary debates on two controversial pieces of legislation. The first is the “anti-terrorism” legislation, approved by Parliament in July 2015, which has been strongly criticized by civil society organizations as potentially undermining constitutional rights. The second is the pending “economic reconciliation” legislation which would pardon individuals who committed economic or financial offenses under the Ben Ali regime, if such individuals return a portion of their illicit gains. Many in Tunisian civil society view this bill as the latest in a series of moves to curtail some of the gains of the 2011 Tunisian uprising.

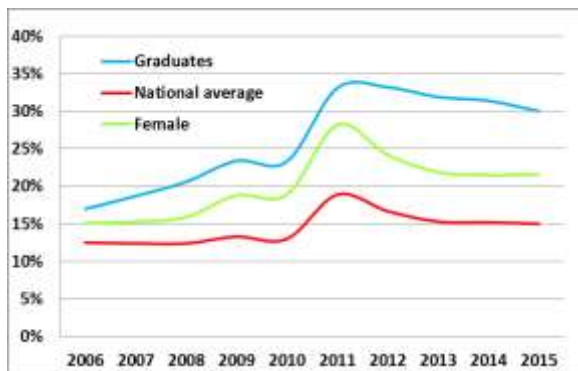
4. ***The international community perceives Tunisia as a regional and global public good.*** International partners reiterated their commitment to supporting Tunisia at the September 2015 G8 meeting based on the view that development and stability in Tunisia is a global public good for both the MENA region and the international community. International partners are particularly keen to make sure Tunisia is not undermined politically or economically by ongoing terrorist attacks.

5. ***Tunisia’s government remains under tremendous pressure to respond to significant economic and social challenges.*** Although the high expectations of many Tunisians for what the democratic transition could bring in terms of development have not been met, very few are calling for an overthrow of the political

system itself. Instead, the pressure is firmly focused on the government to show tangible results on the economic dividends of democracy, especially by creating jobs for the unemployed youth, strengthening governance and service delivery. The new government is committed to address these challenges in cooperation with the civil society – including the Quartet - to maintain social peace.

6. ***Public dissatisfaction with the economic situation—particularly unemployment—remains high.*** Tunisia’s economy is still functioning along the pre-revolution game rules with continuing elite capture. Structural reforms designed to soften the monopolistic economic model and “break away from the past” have not been fully implemented. Without these reforms, the economy has little chance of reaching the growth rates that are needed to make a significant impact on high unemployment and living standards.

**Figure 1: Unemployment Rates  
(in percent, eop)**



Source: INS

Unemployment stands at 15.4 percent nationally, representing about one million people. The decline in unemployment from its peak of 18.9 percent in 2012 after the revolution is plateauing, as ad-hoc civil service and parastatal recruitments cannot be sustained. Youth unemployment is staggeringly high at around 30 percent, as are unemployment rates among the educated and women. A quarter of new graduates are out of work nationally (see Figure 1), a figure which rises to between 31 percent and 48 percent in the least developed central and southern regions of the country. Women are still hit hardest by unemployment, although gender equality is embedded in the new Constitution. Structural weaknesses already underlying youth unemployment (e.g., the mismatch between skills supply and demand of labor) are now compounded by external factors such as the economic stagnation in the European Union, Tunisia’s main trading partner.

7. ***The youth were those that took to the streets in the largest numbers during the 2011 revolution and there is increasing frustration among them that besides increased voice, the pre-revolution economic model which results in cronyism and exclusion is still in place.*** The inability of youth to access the opportunities promised in the social contract of adulthood—including quality education, viable employment, and marriage and family formation—has led to massive resentment motivating youth to actively seek change within their country and region. As highlighted by a World Bank report<sup>1</sup>, young Tunisians have little trust in public institutions, and only 8.8 percent of rural youth and 31.1 percent of urban youth trusted the political system in 2013. Trust in the police is low. In comparison, the military, the local Imam, religious institutions received the highest trust ratings by youth of up to 80 percent, nearly the same level of trust given to the family. While most young Tunisians continue to engage in positive youth activism through virtual means and civil society engagement, a small group has been increasingly attracted to violent jihad.

<sup>1</sup> Tunisia: *Breaking the Barriers to Youth Inclusion*, World Bank, 2014

8. ***In this difficult context, the Nobel Prize is more than just an acknowledgment of the quartet's brave and dedicated efforts.*** It also serves to highlight Tunisia's remarkable progress and encourages civil society to hold the consensus and inclusion course going forward while also encouraging other countries in the region to follow its lead.

#### **Box 1: Tunisia and the 2011 Revolution**

***Despite decades of strong economic performance and social improvements, widespread corruption and increasing concerns about economic performance, persistent inequalities, insecurity and lack of opportunity led to the 2011 Revolution and the ousting of former president Zine al-Abidine Ben Ali.*** Tunisia's strong performance included a fivefold increase in per capita income in the first 40 years after independence, during which all social and economic indicators improved significantly (e.g., life expectancy grew from 50 to 75 years) and poverty incidence dropped drastically. The country also jumped up international rankings of competitiveness. Yet, widespread corruption, coercion and political interference, in addition to the lack of public accountability, transparency and voice—which all peaked in the decade preceding the revolution—undermined social stability and the economy's ability to take off and bring prosperity and good jobs to all. The triple demand of the revolution for "*employment, freedom and dignity*" revealed that despite some economic and social success, growing frustrations, political and economic disenfranchisement, loss of dignity and voice remained a reality for many Tunisians.

***Tunisia also failed to create inclusive growth, which translated into wide socio-economic disparities.*** The deep-rooted dichotomies of the Tunisian model emerged along several dimensions: in the *economy* (e.g., the duality between the more dynamic exporting offshore sector and the protected and stagnant onshore sector where vested interests shielded key sectors from competition); *spatially*, between the thriving coastal regions and the impoverished interior areas; and, in the *labor market*, between the insiders, who benefitted from secure jobs (mostly in the public sector) and the outsiders, increasingly young and educated Tunisians who experienced growing unemployment rates and jobs insecurity.

## **B. RECENT ECONOMIC DEVELOPMENTS**

9. ***Economic growth in Tunisia has been volatile over the past decade and slowed down considerably following the 2011 Revolution.*** While Tunisia showed some resilience to the 2008 financial crisis, growth plunged after the Revolution and recovered only modestly since. A short-lived rebound in 2012 did not lead to a sustained economic recovery as investment has declined while consumption has started leveling off. In 2013 and 2014, real GDP growth stood at 2.3 percent. Expansion in services and administrative sectors were offset by a declining extractive sector and a stagnant manufacturing sector. External demand has remained low reflecting stagnation in the Eurozone, while domestic demand slowed as a result of tighter macroeconomic policies. The social tensions that marked the first half of 2015, as well as the combined effect of the two terrorist attacks in March and June 2015 further negatively affected activity in the first half of 2015, leading the economy into two consecutive quarters of negative quarter-on-quarter growth (-0.2 percent and -0.7 percent).

10. ***Inflation peaked in 2013 but has since decelerated.*** Inflation rose to 5.8 percent in 2013 from 3.5 percent in 2011. Food and energy prices have been the main drivers of inflation dynamics over the past few years. Although electricity tariffs (related to the gradual phase-out of subsidies) and food prices rose in 2014 they subsequently decelerated and inflation stabilized at 4.9 percent and is expected to stay moderate if international fuel prices remain low and the central bank maintains a tight monetary policy stance.

11. ***Low growth and greater external imbalances threaten macroeconomic and fiscal sustainability.*** The fiscal deficit increased from 1 percent of GDP to 6.2 percent between 2010 and 2013 and the public debt from 40.7 percent of GDP to 44.8 percent during the same period. Current account imbalances have risen since 2011, as a widening trade deficit could not be offset by net service imports, notably tourism, due to the uncertain political and security situation. A more flexible stance in the exchange rate policy, together

with heavy reliance on external financing from international financial institutions (IFIs), helped preserve an acceptable level of international reserves<sup>2</sup>.

12. ***Post- revolution, fiscal policy has been biased towards recurrent spending, while public investment has suffered from both budget constraints and bottlenecks in project execution.*** While the fiscal deficit has been higher than before the revolution on average, it did not translate into the accumulation of arrears and met the program targets of the Stand-By Agreement concluded with the IMF in 2012 while the resulting increase in public debt has remained sustainable. The composition of spending, however, is problematic, as the bulk of the adjustment was borne by lower capital spending reaching a record low in 2014 (4.8 percent of GDP). The challenge of finding a balance between fiscal consolidation and maintaining social peace is illustrated in the continued increase of the wage bill and subsidies until 2014, despite freezing on salaries and hiring of public servants and gradual increase of subsidized fuel prices. In 2014, the wage bill reached 12.7 percent of GDP (against 10.6 percent in 2010), and subsidies and transfers represented 7.2 percent of GDP (against 3.6 percent in 2010). The government's recent decision (September 2015) to increase wages starting in 2016 by an equivalent of 0.7 percent of GDP undermines the efforts to slow down recurrent spending growth and progressively improve expenditure composition.

13. ***Considerable fiscal risks exist and need to be addressed.*** Subsidies have become a growing fiscal burden, reaching approximately 24 percent of total spending. Fuel subsidies reached two-third of total subsidies budget in 2013, against less than a third in 2009, equivalent to almost 90 percent of the combined expenditures for health and basic education. Fiscal risks and contingent liabilities of SOEs are also increasing, as demonstrated by the rise of external debt from public enterprises guaranteed by the government to 34 percent of the total external government debt (10 percent of GDP) by end 2013, of which the Société Tunisienne d'Electricité et de Gaz (STEG), the public power utility of Tunisia accounted for 40 percent. Against this backdrop, the government is initiating a more transparent fiscal risk management system through improved monitoring of cross-subsidies, audits and consolidations of financial situations of the largest companies, and the governance framework of public enterprises. The necessary stabilization of the macro-fiscal situation will require continued action on civil service reform and State-owned enterprises (SOE) restructuring.

### C. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

14. ***The economic outlook is affected by the strong impact of the security shock and the social tensions that marked much of 2015.*** The Bank forecasts GDP growth to drop to 0.8 percent in 2015, with further downside risk, before recovering towards 3 percent in 2016-18 in a positive scenario of accelerated reforms, continued reinforced security, an improvement in the regional situation (most notably a start of normalization in Libya) and a moderate acceleration in external demand. Inflation is expected to further decelerate to 4.2 percent per annum on average in 2015-18. The lower international energy prices have limited pass-through to consumers on account of administrative prices, and its impact on external balances will be partly offset by the gradual depreciation of the Tunisian Dinar. In line with the approved 2015 budget law, further consolidation of recurrent spending is expected to take place in 2015 (-0.9 percent of GDP), thanks to restraints on the wage bill. However, this will be reversed in 2016-18 on account of the announced wage increase starting in 2016 if no compensatory measures are implemented (e.g. freeze in recruitment, promotions, bonuses). The trade balance will only moderately improve over the medium term, but the outlook for the balance of payments is likely to benefit from the gradual recovery of net service trade, even if tourism in 2015 will be affected by the security situation. Consequently, the current account

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<sup>2</sup> In January 2015, when Tunisia launched a US\$1 billion sovereign bond without guarantees from international community, it demonstrated strong international investor confidence in Tunisia.

deficit would improve gradually towards 6 percent of GDP by 2017. International reserves are projected to stabilize at around 4 months of imports (goods and services).

15. *While public and external<sup>3</sup> debt remained at an acceptable level compared to international standards, they could worsen markedly if reforms are not implemented or if the economy is affected by adverse fiscal or exchange rate shocks.* Prudent debt management and sustained growth reduced public debt from 52 percent of GDP in 2005 to 40 percent in 2010, of which almost 25 percent was foreign debt. Total external debt dropped from 60 percent of GDP in 2004 to 46 percent of GDP in 2010 (of which 37 percent of GDP was medium and long term debt). Public debt and external debt started to increase again in 2011 as a result of the financing needs associated with the response to the post-revolution economic crisis and downturn. A recent debt sustainability analysis<sup>4</sup> shows that if fiscal consolidation reforms are not implemented, public debt could reach around 62 percent of GDP by 2019, while a permanent negative growth shock would increase it further to about 67 percent of GDP by 2019.

**Table 1. Selected Macroeconomic Indicators, Actual and Projected, 2011- 2018**

Fiscal year	2011	2012	2013	2014	2015	2016	2017	2018
	Act.	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.
Real GDP growth rate (%)	-1.9	3.9	2.3	2.3	0.8	2.8	3.7	4.5
Unemployment rate (End of period, %)	18.9	16.7	15.3	15.3	15.7	...	...	...
Inflation (CPI Index, Period Average)	3.5	5.1	5.8	4.9	5.0	4.3	4.0	3.7
FDI (% GDP)	0.9	3.9	2.4	2.1	2.1	2.8	3.2	3.5
Gross domestic investment (% GDP)	23.6	24.3	22.0	19.2	19.4	20.0	21.9	23.7
Of w: Private investment (% GDP)	16.4	17.6	18.2	18.4	18.5	19.0	19.3	19.8
Fiscal balance (excl. exceptional receipts, % GDP)	-3.5	-5.7	-6.2	-4.1	-6.7	-4.1	-3.4	-3.0
Current Account Balance (% GDP)	-7.4	-8.2	-8.3	-8.8	-8.4	-7.8	-6.9	-5.9
Official Reserves (months of imports)	3.4	3.9	3.9	3.9	4.0	4.0	4.1	4.2
Public debt ratio (% of GDP)	44.5	44.5	44.8	49.5	55.7	58.1	53.5	52.3

Source: National Authorities and Bank Staff Calculations. Bank Staff Projections.

#### D. POVERTY PROFILE

16. *Tunisia has made impressive strides in poverty reduction before the revolution, with the poverty incidence being halved between 2000 and 2010, from over 32 percent to 15.5 percent (figure 2).* Equally impressive is that extreme poverty has more than halved during the same period, from 12 percent to less than 5 percent of the population. Declines were consistently observed across regions, urban and rural strata.

17. *Post revolution, estimates suggest that poverty rates increased in 2011 immediately after the revolution and decreased in 2012 (figure 2).* The poverty impact of the revolution in 2011 oscillates between 0.9 and 2.2 percentage points, depending on the assumptions used to project post revolution poverty rates.<sup>5</sup> The recovery of GDP and employment in 2012 contributed to reversing the poverty increase of the previous year, while the increase in the cost of living limited the favorable impact on poverty of the

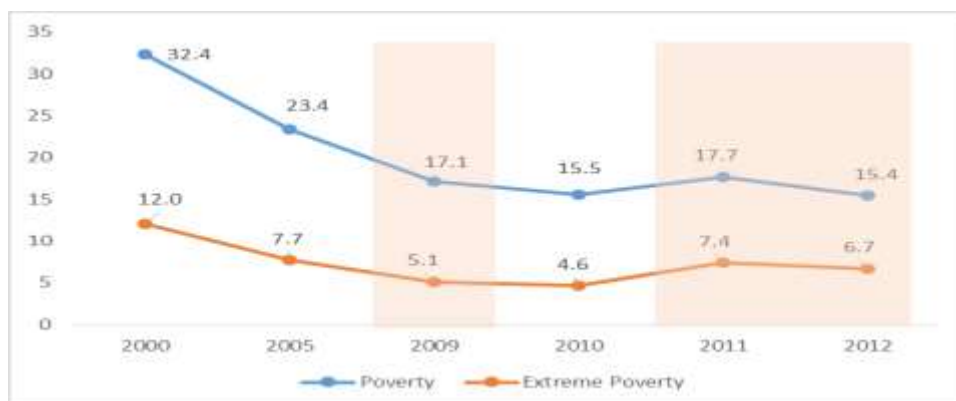
<sup>3</sup> External debt has also increased since the revolution, reflecting the fiscal expansion and the widening of the current account deficit.

<sup>4</sup> IMF Fifth review of SBA (December 2014).

<sup>5</sup> These findings accrue from projections of the observed household consumption in 2010 (reported in the ENBCV) that are updated consistently with the macroeconomic developments in 2011 and 2012.

economic recovery. All in all, estimated poverty rates in 2012 are slightly below 2010 levels. Projected extreme poverty rates for 2010 and 2012 suggest similar trends (figure 2).

**Figure 2. Poverty and Extreme Poverty Trends form 2000-2012**



Source: World Bank (forthcoming) poverty assessment using ENBCV data, INS estimates of unemployment and CPI and INS, African Development Bank and World Bank (2012) “*Mesure de la pauvreté, des inégalités et de la polarisation en Tunisie 2000–2010.*” Tunis, INS. Post-revolution estimates refer to poverty projections using sectoral GDP, unemployment rates and inflation adjustments.

Notes: Shaded areas indicate Bank staff’s estimates; non-shadowed areas, official estimates.

18. ***The reduction of poverty in Tunisia has been a generalized phenomenon that has benefited the most disadvantaged but has also extended to other population groups.*** Growth incidence curves—which report consumption growth rates across the distribution of households in a society—, confirm uniform increases in consumption around a 3 percent growth rate per year between 2005 and 2010 for the vast majority of households. Only the richest 20 percent of Tunisian households experienced lower consumption growth, 2 percent.

19. ***Paradoxically, the growth in consumption that led to impressive poverty reductions did not translate in reductions in disparities.*** Overall consumption inequality between 2000 and 2010 decreased only slightly: the Gini index went from 0.375 to 0.358 in those years. Furthermore, inter-regional inequality substantively increased resulting in the poorest regions in the country –the North West, Center West and South West– concentrating 70 percent of the extreme poor (and 55 percent of all poor), despite hosting only 30 percent of the population. Similarly, unemployment rates show considerable disparities across regions, and are especially high in the interior rural regions (see Table 2 below).



Table 2. Tunisia poverty and extreme poverty rates show wide and persisting regional disparities

	Poverty rates			Extreme Poverty rates			Percentage of poor		Percentage of extreme poor	
	2000	2005	2010	2000	2005	2010	2000	2010	2000	2010
Tunisia	32.4	23.3	15.5	12.0	7.6	4.6	100.0	100.0	100.0	100.0
Greater Tunis	21.0	14.6	9.1	4.3	2.3	1.1	14.1	13.6	7.8	5.5
North East	32.1	21.6	10.3	10.5	5.4	1.8	13.5	9.2	12.0	5.4
North West	35.3	26.9	25.7	12.1	8.9	8.8	14.2	19.1	13.2	22.0
Center East	21.4	12.6	8.0	6.4	2.6	1.6	14.4	12.0	11.6	8.1
Center West	49.3	46.5	32.3	25.5	23.2	14.3	22.0	27.7	30.7	41.3
South East	44.3	29.0	17.9	17.5	9.6	4.9	12.9	10.5	13.7	9.7
South West	47.8	33.2	21.5	21.7	12.1	6.4	8.7	7.9	10.7	7.9

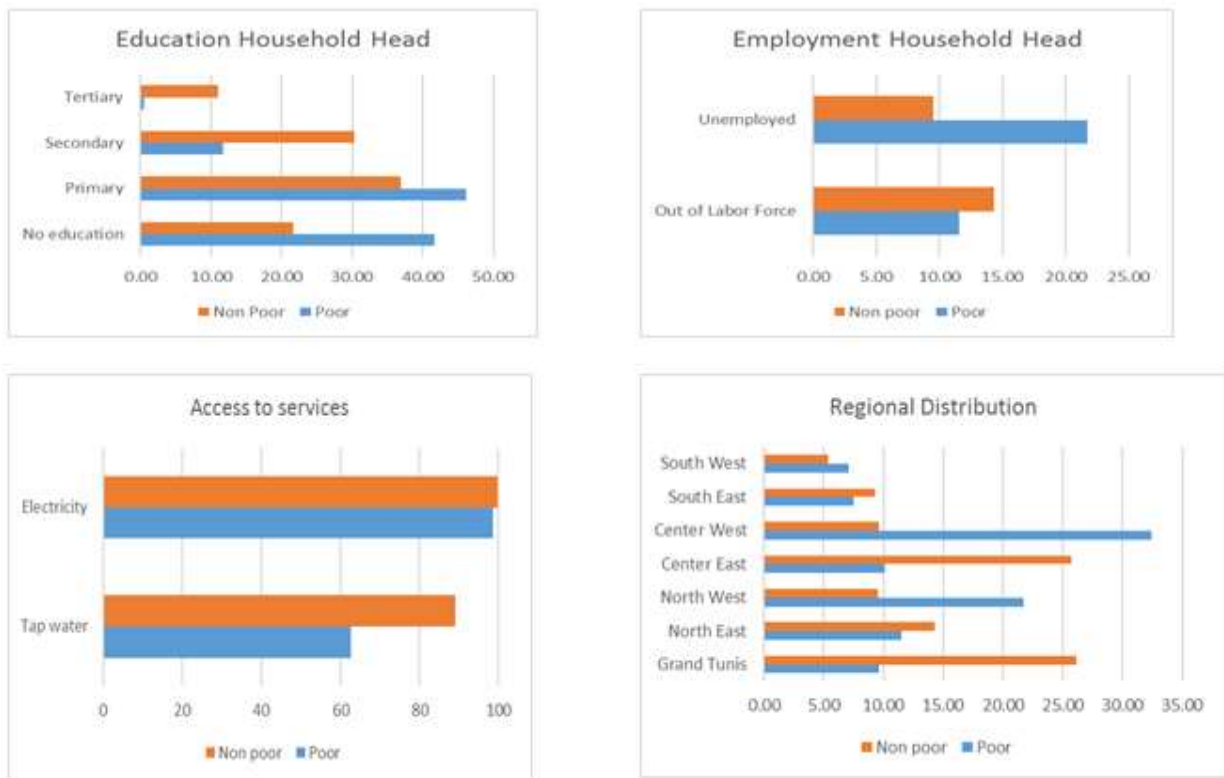
Source: INS and authors calculations<sup>6</sup>

20. ***Vulnerability to poverty remains high in Tunisia although it has declined over time.*** Based on a recent internationally accepted definition –as those non-poor households with a probability of 10 percent or higher of becoming poor–, about 56 percent of the population in 2005 and still 46 percent in 2010 would be considered vulnerable to poverty. This is a notable level of vulnerability in the context of post revolution Tunisia with a relatively volatile GDP growth, increasing inflation, sensitive unemployment rates, and reforms that can potentially lead to sudden sizeable consumption swings.

21. ***In spite of improvements, post-revolution poverty profiles are very similar to those observed pre-revolution.*** In fact, the 2012 profiles do not provide evidence in favor of substantial changes with respect to 2010 in most of their tracked demographics, geographical concentration, labor conditions, access to services, and asset ownership. The poor in 2012 continued to live in more crowded households than the non-poor. The share of rural poor exceeded that of the urban poor (56 percent and 44 percent, respectively). The post revolution poor are also concentrated disproportionately in western regions. In 2012, the shares of out of labor force and unemployed heads were very similar to those observed pre revolution in 2010: almost one-third of the non-poor were out of labor force (27 percent among the poor). The proportion of unemployed poor was 3.5 times larger than the unemployed non-poor. Post revolution poor household heads keep working in agriculture, industry, and services on equal shares, about 33 percent each. About 24 percent of non-poor household heads were professionals, compared to only 5 percent among poor households. Regarding access to services, important gaps on the access to safe water existed between the poor and non-poor as observed in previous years (63 percent and 89 percent, respectively), while for electricity, access remained virtually universal (over 99 percent for both poor and non-poor).

**Figure 4. 2012 Profiles for Poor and Non-poor (as % of population within each category with a given characteristic)**

<sup>6</sup> Please note that the percentages of the poor and extreme poor are based on population data from INS adjusted from governorates into the regions– weights from HBS are not applied so there might be slight difference from the final results that will be obtained with the HBS data.



Source: World Bank staff's estimates using ENBCV 2010 and ENPE 2012.

22. ***The bottom 40 (b40) percent of the population –critical to determine the extent of shared prosperity in a country– aligns closely with the socioeconomic profile of Tunisian poor.*** Thus, 44 percent and 43 percent, respectively, of poor and b40 households live in urban areas. The concentration of poor and b40 households geographically is similar in western regions (50 percent of the b40 live in those regions). Relative to labor, the distribution of sectors among the poor and b40 aligns closely (each category comprising about one-third of working household heads), as is also the case for the professional categories considered in this analysis. Regarding basic services, access rates to tap water, flush toilets, and sanitation services of b40 households are closer to those access rates of the poor than the non-poor. This close alignment between poor and b40 percent populations is observed for 2005, 2010, and 2012.

23. ***A series of economic and social policy miscues have contributed to hinder the broadening of inclusion and reduction of inequalities in Tunisia.*** Investment policy has long been founded on a separate treatment of companies producing for export (offshore) and domestic (onshore) markets. The result is greater imports of intermediate products; fewer domestic jobs; low demand for high-skilled workers; and low salaries. Incentives to attract investments and favor job creation are highly concentrated in sectors that are not labor intensive and in coastal regions – with the exception of textile, the type of investment that has benefited most from the government's offshore incentives has been in mining, energy and banking —thus exacerbating regional disparities. When flexible contracts were introduced in the early 2000s, investments went to low-skilled and informal jobs in low-value-added activities, away from high-skilled jobs. Furthermore, many believe that a substantive share of generous social spending on subsidies, safety nets, and basic rural infrastructure –originally designed to improve people's welfare and appease social tensions– have gone unaccounted for and distributed through clientelistic networks by the ruling party.

24. *On the positive side, the development of an export-oriented labor-intensive sector (inclusive of low-skilled female workers) such as textile and garments manufactures; the expansion of the tourism industry near the end of the 90's; control of inflation; increasing investments in rural agriculture; and generous food subsidies that facilitate and incentivize the increase in agricultural output all contributed to economic growth and increasing living standards of Tunisians.* Increases in minimum wages; strong investments in human capital; rural development programs that expanded infrastructure, roads, water supply and sanitation; generous—albeit poorly targeted—energy subsidies; and employment creation, training programs and social investment funds programs have also contributed to sustain poverty reductions over decades.

25. *Looking forward, shared prosperity in Tunisia faces important challenges.* Ultimately, all the jobs that could have been created, but were not, are missed opportunities to integrate the unemployed into the economy. Consumers as a whole pay higher prices from monopolistic and heavily regulated industries. Since only a few people have traditionally had access to those in power to capture benefits, the majority of Tunisians missed these economic opportunities, which led to feelings of deep social injustice that grew into frustration. Growth in Tunisia may have been pro poor but incapable of substantively reducing inequalities and broadening inclusion in a society that ended up rebelling in the Arab Spring. Marginal reforms to a model stuck for decades in low productive activities, favoritism towards specific regions, and exclusion from economic opportunities will not be sufficient. Instead, the inevitable economic overhaul needed to bring about inclusive prosperity is of a large caliber, involving deep changes that threaten the social stability and consensus so badly needed for reform implementation in the first place.

**Box 2 – The relevance of the World Development Report 2009: Reshaping Economic Geography (WDR 2009), to Poverty reduction in Tunisia**

Many developing countries are facing the same challenge of reducing spatial differences in living standards. The structural transformation that takes place as countries grow from low to high incomes is accompanied with prosperity in a few places, as has been observed from the history of many developed countries, and is being repeated in many developing ones, such as China, India, Indonesia, and Sri Lanka. According to the World Development Report 2009: Reshaping Economic Geography (WDR 2009), unbalanced growth is the norm, but development can still be inclusive. How then can uneven landscapes of growth deliver inclusive development?

The main messages of the accompanying piece to the WDR2009 [\*Poor Places, Thriving People: How the Middle East and North Africa Can Rise Above Spatial Disparities\*](#) can be summarized in four words: people, connections, clusters, and institutions.

- The surest way to help a lagging area to catch up is to **invest in its people**. A lack of education (especially for girls) and high dependency ratios are the essence of the lagging region phenomenon;
- MENA has a proximity premium: its lagging areas' populations are rarely far from its growth hubs. The report shows how smart investments and policies in transport can **connect poor places to the dynamic economies of their rich neighbors**. There is also a wide-open field of opportunity for telecommunications to bring electronic proximity to lagging areas;
- Many countries have spent huge sums on subsidies to entice investors to lagging areas—usually without any sustainable impact. The report recommends that governments turn their efforts toward the **new approach to local economic development**, which is gaining ground around the world, and is based on economic clusters, local competitive advantage, private initiative, and public-private dialogue.
- MENA's historical legacy is one of centralized and sectorally compartmentalized institutions. However, as the region's governments increase their focus on **integrated local development**, they are exploring new institutional models that are more suited to their needs. The report describes the state-of-play in territorial planning, public financial management, targeted programs, deconcentration, and decentralization, and it sketches some emerging lesson.

## II. THE SYSTEMATIC COUNTRY DIAGNOSTIC: DRIVERS OF POVERTY REDUCTION AND DEVELOPMENT CHALLENGES

26. *Despite significant progress towards a more open and transparent society and a democratic and pluralist economic system, substantial action is still required for an economic transformation fostering sustained and inclusive growth.* Boosting shared prosperity will require a concerted effort to renew the social contract, particularly in the area of promoting equality of opportunity. In the case of Tunisia, this will mean first and foremost re-establishing trust in public institutions and civil servants and ensure active citizen participation. Significant progress has been made by the transition governments to strengthen transparency and participation, particularly in terms of marked improvement in political rights, increased freedom of press and non-governmental organizations (NGOs) and first steps towards improved economic governance. Deep structural reforms are now needed to enable a lasting economic recovery, following the path of other upper middle-income countries (MICs) which have performed much better than Tunisia over the past two decades. These reforms would need to tap on the country's underlying capabilities and re-align incentives to facilitate sustained and inclusive and high value-added growth, and go beyond the successes achieved so far of rapid overall poverty reduction. Tunisia needs now to accelerate the reforms and proceed to implement the next generation of deep and vital reforms. This new development model would be key for Tunisia's success in forging a new social contract to redefine the relationship between the Government and the various stakeholders in society and unleash the potential to achieve higher growth and shared prosperity.

27. *The Systematic Country Diagnostic (SCD) identified two key drivers for reducing poverty and enhancing shared prosperity, as well as two pre-conditions, or over-arching issues, which must be addressed in order to achieve sustained economic growth in Tunisia.* The two pre-conditions that are the foundation for the success of Tunisia's development efforts are macroeconomic stability and improved governance. The SCD also discusses the importance of social cohesion and security. The two key drivers for which Tunisia will need to take sustained initiatives are: (i) promoting private sector-led job creation; and, (ii) improving equality of opportunities and support those who might be left behind (in particular the youth in the lagging regions).

### Macroeconomic Stability

28. *As previously discussed, the emerging macroeconomic imbalances and challenges are amongst the major obstacles to accelerate growth and to put Tunisia on a sustainable economic development path.* The macroeconomic and fiscal environment exhibits large vulnerabilities which, if not addressed, will prevent growth from achieving its full potential and sustained job creation based on a deep structural transformation. Deeper medium-term structural reforms are essential for improving Tunisia's macroeconomic and fiscal prospects, increasing the confidence of both domestic and international investors, and for the country's ability to reduce poverty and boost shared prosperity. Fiscal consolidation should be based on increasing low tax revenues and reducing high spending, particularly on fuel subsidies, where the Government has taken encouraging steps. On the spending side, the wage bill drift needs to be reversed or at least contained through stricter controls and rationalization.

### Security

29. *The Government's main challenge is to maintain security as a prerequisite for restoring economic activity and putting the economy back onto a growth trajectory.* The estimated 50 percent fall in tourism revenue not only slowed the economy further, but also led to smaller foreign-exchange reserves and a higher current-account deficit. Foreign direct investment, already low, could also be scared off by insecurity. Finally, the weight of the combined budgets of the Tunisian ministries of defense and interior witnessed a 15 percent increase this year which supported a set of measures including strengthening intelligence and border protection. The 2015 revised budget also shows increased security expenditures.

## Improved Governance

30. ***Improving governance is critical for achieving sustainable growth and reducing poverty.*** Tunisia is challenged by: (a) a still weakly anchored rule of law; (b) excessive centralization of the decision-making process and regions still lacking the autonomy and resources needed to forge a local development dynamic ; (c) low level of citizen participation in political, economic and social matters, particularly on the part of youth and women especially in rural areas; (d) a high level of elite capture through restrictions on economic participation<sup>7</sup> as embodied by a web of regulatory favoritism that minimized competition; (e) high level of small corruption/bribery<sup>8</sup>; and, (f) weak institutional capacity. In effect, the governance system was molded around furthering elite capture while eliminating effective means to challenge official policies and government actions. Governance systems and related institutions were themselves undermined or neglected, thus resulting in weak delivery of services to the public. Improving the Governance system will require two-pronged approach focusing on long-term gains while creating an environment propitious to shot-to-medium-term improvements,

### ***Key Driver 1: Promoting Private Sector-Led Job Creation***

31. ***Reforms of the business environment and financial sector have great potential for growth, private sector job creation and ultimately inclusion.*** Removing the barriers to entry and competition would substantially improve the performance of the Tunisian economy and boost the ability of the most productive firms to grow and create good quality jobs. The removal of barriers to market competition should start with backbone services sectors and sectors with high potential for job creation, notably commerce, education, health services, transport, energy and telecommunications to open up investment in these sectors. A drastic simplification of the pool of regulations hindering private sector activity, which would reduce the room for discretion in their implementation, is also critical. Improved access to credit opportunities to firms, particularly those with no credit history and limited collateral (mostly MSMEs and startups) by reforming the banking sector and developing alternative sources of financing, will enable resources to be channeled to the most productive projects and increase the quantity of financing available to the private sector for investments<sup>9</sup>. To improve the efficiency of the banking system and competition within the sector, priority should be given to strictly enforcing bank regulation, revising the procedures to deal with banks in financial difficulty, and restructuring or privatization of State Owned Banks (SOBs). Finally, increasing financial inclusion (access to and usage of formal financial services) is critical for household welfare by spurring private sector economic activity and helping manage economic shocks.

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<sup>7</sup> *The Unfinished Revolution: Bringing Opportunity, Good Jobs and Greater wealth to All Tunisians*, May 2104 - [http://www.worldbank.org/content/dam/Worldbank/document/MNA/tunisia\\_report/tunisia\\_report\\_the\\_unfinished\\_revolution\\_eng\\_synthesis.pdf](http://www.worldbank.org/content/dam/Worldbank/document/MNA/tunisia_report/tunisia_report_the_unfinished_revolution_eng_synthesis.pdf)

<sup>8</sup> Global Financial Integrity estimated that the amount of illegal money lost from Tunisia due to corruption, bribery, kickbacks, trade mispricing, and criminal activity between 2000 and 2008 was, on average, approximately two percent of GDP per year (about US\$1.2 billion). The IMF estimates that the informal economy represents 30% of Tunisia's GDP (IMF, 2011).

<sup>9</sup> Better performance in the banking sector could increase the level of credit to the private sector by at least 10 percent of GDP, which could generate in excess of US\$10 billion in additional investments to be injected in the economy over the next 10 years, corresponding roughly to an additional 38,000 additional jobs per year (Tunisia 2012 DPR).

## ***Key Driver 2: Improving equality of opportunities and support to those left behind***

32. ***To address the needs of the very large unemployed population (mostly youth), a new integrated job strategy needs to be in place to contribute to shared prosperity.*** It needs to cut across dimensions and link policies that facilitate the creation of new jobs in the private sector with policies that support increased productivity. It would also require decreasing the skills mismatch in the labor market. The government can play an active role in accompanying the development of high potential sectors through horizontal measures and addressing coordination failures. Policies to improve the overall business environment would need to be complemented with targeted interventions aiming to create jobs in specific sectors and regions.

33. ***These job creation policies will also need to be accompanied by reforms of the social insurance and labor regulations to incentivize formal employment.*** The focus should be on reducing taxes on labor and other labor costs<sup>10</sup>, while guaranteeing adequate income protection to workers. Employment protection legislation plays a critical role in facilitating industrial stability, the build-up of firm-specific human capital and innovation. Moving forward, it will be important to accompany the targeted investment policies with employment policies fostering greater job creation and economic growth.

34. ***To support the most vulnerable groups of the population, effective, transparent, and sustainable social protection systems, that can be easily scaled up, will be essential.*** Strengthening Tunisia's social protection system is a necessary complement to pro-growth reforms in order to effectively protect the poor and vulnerable, and to ensure that the poorest are not left behind. The equity and effectiveness of Tunisia's social protection system constitutes a core aspect of Tunisia's development model. Improved targeting of the current model would allow better protection of the poorest and soothing inequality and social tension.

35. ***A clear enhancing factor towards more inclusive growth is provided by policies aimed to address spatial inequalities in access to and quality of basic services, access to good infrastructure, and more generally targeting institutional failures that generate unequal "opportunities".*** Increase parity of access to quality basic services (notably water, health and education services) in lagging areas will improve people's employment, their quality of life, and ultimately contribute to long-term economic growth. Improving the governance, institutional and regulatory framework to allow both more accountable and more efficient services would incentivize private investment and allow more viable service provision, hence reducing enduring inequality in access and quality across regions. Tunisia's commitment to decentralization is demonstrated in the new Constitution's provisions on local governance structures and empowered elected local entities.

## **III. WORLD BANK GROUP PARTNERSHIP STRATEGY**

### **A. GOVERNMENT PROGRAM AND MEDIUM-TERM STRATEGY**

36. ***Following the 2014 presidential and parliamentary elections, President Essebsi appointed a Prime Minister tasked to form a coalition government.*** The Prime Minister also led the preparation of a "Note d'Orientation Stratégique" (guidance note for the 2016-2020 development plan) defining Tunisia's development vision and strategic orientations for the next five years, with significant involvement from the civil society and the international community and endorsed by the council of Ministers in September 2015. This note is the basis on which line Ministries build their respective development plans. All plans will serve as key inputs for an international donor's conference planned for the first half of 2016.

37. ***The Note d'Orientation is underpinned by analytical work advocating for a structural transformation of the economy toward higher-value added sectors.*** It presents an alternative development model that targets more "economic efficiency based on innovation and partnership, social inclusion and

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<sup>10</sup> Reducing the tax-wedge, rationalizing redistributive arrangements, reforming dismissal procedures, and reducing discretion in the setting of the minimum wage.

sustainable development." This lens is a "break from the past" as it combines Tunisia's post-Revolution values with a new economic model. The note's objectives assume a more effective improvement of the business environment, as well as progress in the implementation of major reforms, especially those related to the modernization of the administration, the revision of the procurement system, the promulgation of a new investment code, the pursuit of tax reform as well as the adoption of a proactive policy to boost public-private partnership. It also defines clearer delineation of Government, civil society and private sector roles, and with the latter becoming Tunisia's premier growth engine.

38. ***The Note d'Orientation's overarching objective is to create an enabling environment conducive to good governance and economic reform implementation that pave the way for higher growth rates.*** It sets an ambitious goal of 5 percent growth in the next five years, a reduction in the current deficit to 6.8 percent of GDP in 2020, and a decrease in the unemployment rate to 11 percent. There are four pillars:

- ***Shifting the economy from a low value-added productivity and low wage jobs model to a "hub economy".*** This would require positioning the economy in global value chains, building larger scale infrastructure and logistics, fostering innovation, promoting investment, increasing productivity for competitiveness, and promoting employment. It seeks to put private sector investment at the heart of growth and job creation whilst strengthening public sector productivity. Export promotion would be the focus to integrate Tunisia into the global economy with a target of 42 percent of GDP by 2020 in exports.
- ***Promoting human development and social inclusion.*** In terms of human development, quality of education remains a top priority to improve employability prospects. Strengthening women's rights and improving employment prospects for women will also be critical, especially in terms of female participation in economic and political activity. Given the tourism collapse, the emphasis will be placed on attracting the Tunisian diaspora. From a social dialogue perspective, actions will be taken to enhance workplace productivity, improve health outcomes (especially in lagging regions), improve living conditions through social housing, institute a state of the art social protection system with a uniform targeting mechanism ("identifiant unique") for all social protection programs, and reform pensions and health insurance schemes to make them more sustainable. The Government targets to reduce extreme poverty from 4.6 percent in 2014 to 2.5 percent by 2020 by increasing human development indicators and allocating at least 20 percent of its budget to social sectors.
- ***Supporting lagging regions by tackling regional disparities between least developed lagging regions and coastal regions.*** In this context, the Government is committed to attract investments in lagging regions by building infrastructure including roads, ports, and railways. In parallel, considerable efforts will be made to support micro-finance institutions in lagging regions while also scaling-up skills enhancement programs for youth enabling them to develop small start-ups. Most importantly, efforts are underway to prepare for local government elections starting with delineating regional and municipal boundaries.
- ***Promoting green growth for sustainable development.*** The Government's first objective under this pillar is a balanced spatial development including all regions in an environmentally friendly manner. The sound utilization of natural resources will also remain a key consideration as emphasis will be put on rationalizing water and energy consumption, while promoting modern agricultural systems that guarantee food security. It sets a target of 12 percent of the country's electricity needs to be coming from renewable energy by 2020.

## **B. PROPOSED WBG COUNTRY PARTNERSHIP FRAMEWORK**

39. ***The proposed WBG Country Partnership Framework (CPF) is based on an understanding of the country priorities, and of the need for flexibility required by the current conditions.*** It draws on lessons learned from past WBG engagement and IEG evaluation while using a set of guiding principles to define priority engagement areas. It is driven by the MENA regional strategy's assessment that traditional World

Bank interventions may not achieve the twin goals of inclusive growth in the region. The proposed CPF is particularly consistent with the first pillar of the MENA's new regional strategy to support the renewal of Tunisia's social contract and help Government address one of the lingering root causes of the January 2011.

#### **4. B. 1 Lessons from CPF Completion Report, IEG Evaluation, and Stakeholder Consultations**

40. *The Bank prepared a draft CPS and ISN Completion Report (November 2014 - attached) which proposes a number of lessons for the Bank to consider in designing the CPF.* The Completion Report evaluated the achievements of the 2010 CPS during its first year of implementation and that of the 2012 ISN covering FY13-14. Key lessons learned include:

- ***Reforms take time and results need to be realistic and modest in a volatile political environment prone to social unrest in a transition country.*** Programs in Tunisia need to take into account the disruptions caused not only by changes in entrenched political structures but also conflicts between groups with different ideologies. It is also important to take into account that discussions on reforms are taking place with new actors and that first order reforms (such as in labor law and the investment code) are difficult to implement in any country.
- ***Leave room for flexibility to respond to emerging challenges.*** The ISN program was envisaged over two fiscal years with adaptable annual targets to build in flexibility for potential delays in the reform and investment program due to the difficult social and economic environment in Tunisia during the ISN period. The Bank Group's flexible approach also allowed the institution to adjust its budget support for the reform program under the GOJ DPL series to be aligned with political economy realities of Tunisia in 2013 and 2014, calibrating the Bank's financing to the level of ambition and feasibility of reform efforts.
- ***Continue to emphasize informing all stakeholders of reforms needed.*** The dissemination of high quality analytical work prepared by the Bank Group helped fuel the fairly void economic debate at the time of the Revolution and has been instrumental in serving to define a policy agenda for the future and creating buy-in on the need for the economic reforms from segments of society
- ***The Bank Group plays an important role in promoting coordination of donors.*** At a difficult juncture in the country's history, the strong donor coordination led by the WBG, with IMF and other development partners, as well as the exemplary coordination between Bank and IFC, allowed for a steadfast and committed international partner to help guide the authorities reform efforts and it was critical for establishing trust and encouraging the authorities to continue forward.
- ***The choice of lending instruments and financing sources is important.*** Experience in Tunisia has shown that the use of the DPL instrument is necessary as a vehicle for policy dialogue and to provide support to ensure macroeconomic and fiscal stability. The DPL was also a vehicle for providing much needed technical assistance and handholding to take forward many difficult reform efforts. Trust funds helped to provide financing for TA linked to the DPL where there was a financing gap in BB. However, Tunisia also experienced a mushrooming of small grants for individual activities, many for innovative post-revolution tasks, that had the unintended effect of increasing Bank Group staff supervision burden and transaction costs with uneven results.
- ***Continue to abide by selectivity principles followed by IFC in engaging only with Tunisian private sector groups that were not politically connected over the previous CPS period.*** Given the high level of politically connected firms in Tunisia during the Ben Ali regime, IFC made a conscious decision to be highly selective in its investment engagements with local Tunisian firms. This high level of selectivity helped ensure limited reputational risk issues and portfolio fallouts from post-Revolution events.



41. ***The Independent Evaluation Group (IEG) undertook a review of the Bank’s performance in Tunisia from FY05-13.*** In its Country Program Evaluation of February 14, 2013, IEG discussed the Bank Group’s changing approach to Tunisia over those years, at times actively challenging the government on governance issues and at other times desisting from openly challenging government despite the impact of poor governance practices on development potential. IEG noted that the Bank continued to set ambitious country-level objectives despite lack of government buy-in to first-order reforms. In addition, critical bottlenecks identified in ESWs were not addressed. The outcome of the Bank program prior to 2011 was found to be unsatisfactory.

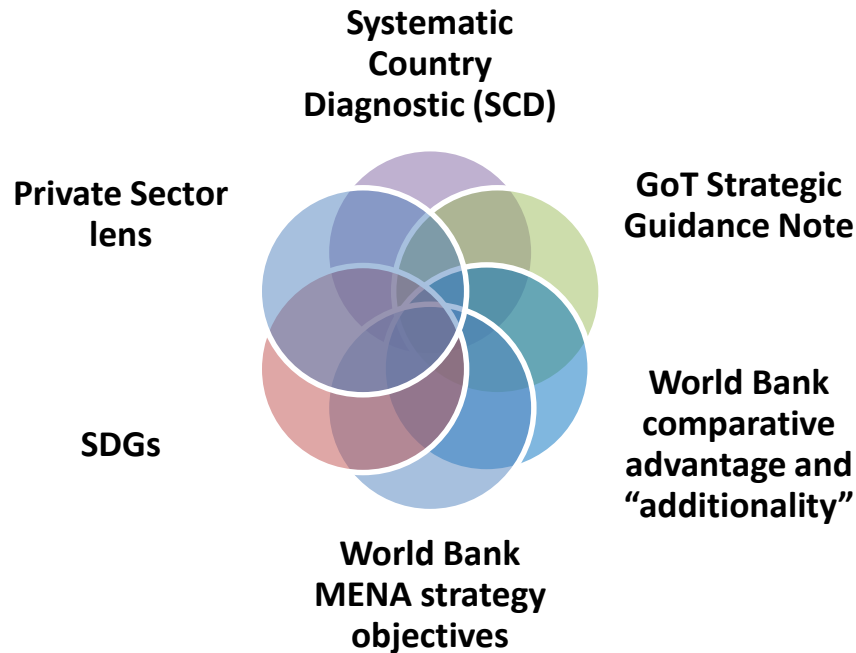
42. ***Following the 2011 revolution, IEG found that the Bank Group established more robust relations with Government and appropriately supported the transition government’s agenda to support voice, transparency, accountability and jobs.*** It also noted IFC’s ramped up engagement to help implement critical reforms supported by Bank lending. While IEG found the Bank program post 2011 to be satisfactory, it recommended the following:

- ***The ISN did not adequately articulate contingencies to put in place should risks materialize.*** The forthcoming strategy should include risk mitigation scenarios based on an ongoing analysis of risks associated with the political economy and conflict, complemented as necessary by specific political economy analysis of reforms in critical sectors.
- ***The Bank Group should reach out to and help inform a broad base of stakeholders, including trades unions, think tanks, other CSOs, and parliament.*** This would help enhance the capacity of stakeholders to raise awareness and gradually build ownership of the reform agenda, thereby helping overcome resistance to change from vested interests. IEG cites the 2013 DPR as an important study for this purpose.
- ***Selectively and carefully sequence first-order policy reforms in the Bank Group strategy, taking into account capacity constraints and other constraints inherent in the transition period.*** Priorities for Tunisia could be to ensure a level playing field through an adequate investment code and competition laws; tackling unemployment by reducing labor market rigidities and taking a strategic approach to youth employment from both the demand and supply sides; and reforming the current subsidies system. IEG commended IFC for its highly selective approach in Tunisia in engaging only with local firms that had passed due diligence on “*politically exposed persons*”.
- ***Facilitate and inform the government in building ownership and capacity on “how to” roll out the reform agenda.*** This will require in-depth interaction with the government to first ensure clear definition, and mutual understanding of the strategic goals on the “what to do”.

#### **4. B. 2 Overarching Framework of World Bank Group Strategy**

43. ***The overarching goal of the CPF is to support Tunisia’s efforts to renew its social contract by defining an economic model with opportunities for those left behind.*** It aims to continue to support structural changes initiated under the previous ISN while addressing near-term challenges created by the fragile environment. It is therefore built around three pillars, namely i) restoring an environment conducive to sustainable growth and private sector-led job creation; ii) reducing regional disparities; and iii) promoting increased social inclusion and reducing fragility with an emphasis on youth and two cross-cutting theme of gender and governance.

#### **Figure 5: Developing the CPF Strategy**

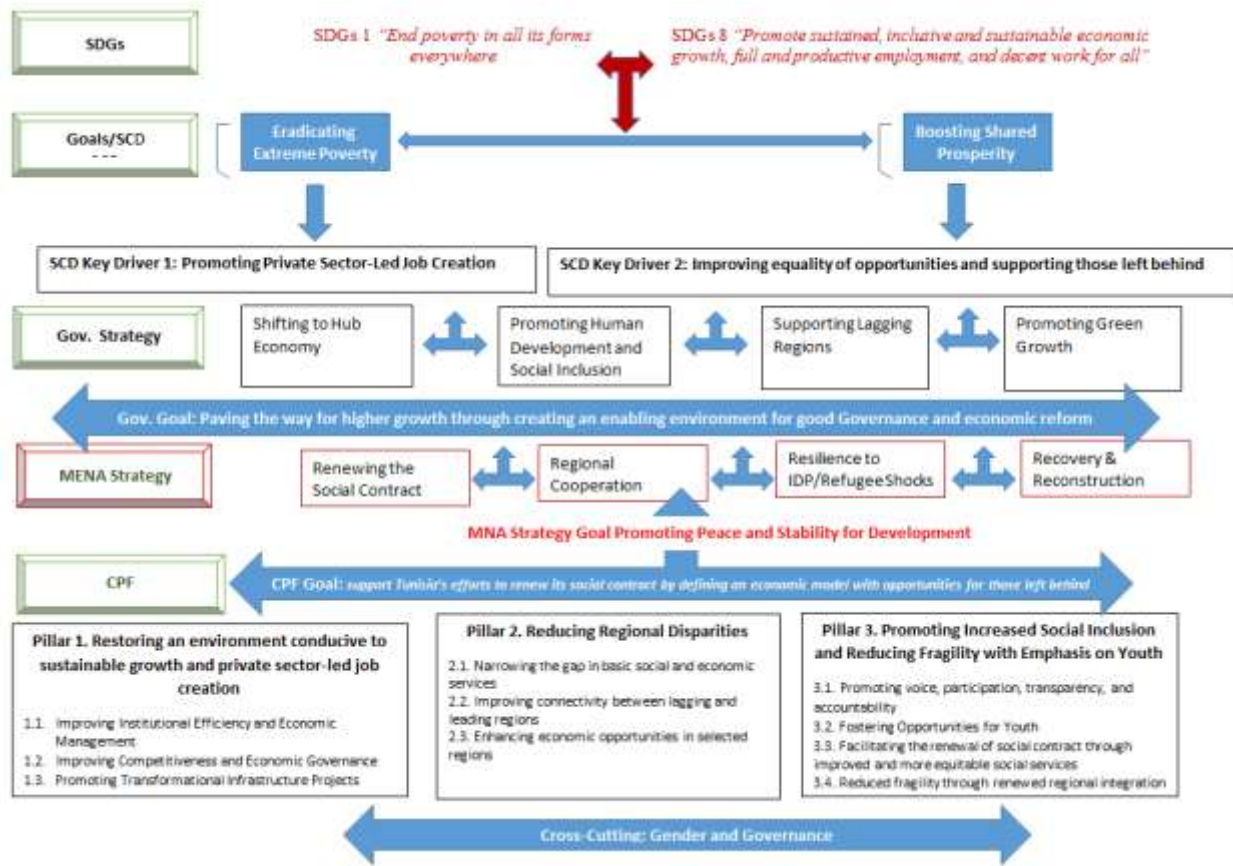


44. *The WBG’s FY16-FY20 CPF is built using four selectivity “guiding principles”:*

- The first “guiding principle” focuses on the two pathways identified in the **Systematic Country Diagnostic (SCD)** to achieve the Twin Goals of eliminating poverty and boosting shared prosperity. These pathways are: (i) promoting private sector-led job creation; and, (ii) improving equality of opportunities and support those left behind.
- The second “guiding principle” is the September 2015 “*Note d’Orientation Stratégique*”;
- The third “guiding principle” is based on two of the **World Bank MENA strategy objectives** to: i) support the renewal of the “social contract” between citizens and the State; and ii) foster greater regional integration.
- Lastly, the fourth “guiding principle” is for interventions that make the best use of the **Bank’s comparative advantage and “additionality”** in terms of integrated solutions that combine local experience, global knowledge, technical assistance, policy dialogue, financing and convening power to catalyze Governmental interventions to achieve a higher impact, and that avoid duplicating other donors’ interventions.

45. *These principles are aligned with the 2030 Agenda for Sustainable Development, which includes a set of 17 Sustainable Development Goals (SDGs) to end poverty, fight inequality and injustice, and tackle climate change by 2030 guide the CPF engagement.* In Tunisia, the World Bank Group works actively in many areas relevant to the SDGs but various evaluations have pointed to the importance of multi-sector integrated approaches that challenge countries and their partners to find new ways of working. The World Bank Group’s twin goals are mirrored in the SDGs, in particular in SDGs 1 “*End poverty in all its forms everywhere*” and 8 “*Promote sustained, inclusive and sustainable economic growth, full and productive employment, and decent work for all*”.

**Figure 6. Tunisia Country Partnership Framework FY16-FY20 architecture**



46. **The WBG's comparative advantage in relation to other donor agencies and the private sector in supporting Tunisia resides in its convening power, global knowledge and its ability to lead policy dialogue in key sectors.** The World Bank Group's main assets in Tunisia are its strong presence on the ground and a history of rapid response and flexibility in the aftermath of crises and its signaling role to mobilize investment flows into countries with high risk perception for investors. While Tunisia can secure project financing from capital markets and a wide array of international donors (including AfDB, ISDB, and European Union), and also obtain technical expertise from numerous international organizations, the WBG brings with it a depth and diversity of services that are unique to the institution.

47. **Finally the Bank adopts a private sector lens throughout its engagements.** The role of the private sector will be increased markedly in all areas of WBG intervention, including (i) social sectors (education) to address issues of skills mismatch of Tunisian youth with labor market needs; (ii) access to finance for MSMEs to support enterprise development and job creation; (iii) high value added and employment generating sectors like tourism, ICT, agribusiness, and health care; and (iv) infrastructure services, especially in the context of public private partnerships (PPPs) to ease the burden of the Government's fiscal position. To this end, in areas where WBG support is needed, the World Bank will provide support to the Government to strengthen the policy and regulatory frameworks necessary for attracting private investments, while IFC will explore opportunities for catalyzing private investment into viable sectors. This includes assistance to address shortcomings in PPP financial attractiveness of socially-desirable projects, assistance to enable PPP development, and deal structuring, as well as guarantees from regulatory and political risks. Other areas of policy support that both the World Bank and IFC will provide is in the area

of investment climate reforms and support for financial inclusion, building on the robust work that the WBG is already delivering in Tunisia.

48. ***Examples of potential for increasing private sector participation assuming a conducive environment for foreign and local investments would be in energy, transportation (e.g. ports, logistics), ICT, water, sanitation, and education.*** Manufacturing and agribusiness companies that focus on value-addition could also be supported through sustainable and efficient operations. Provided the overall Tunisian investment climate improves through effective implementation of long-delayed key economic reforms, IFC will contribute to restore investors' confidence and develop demonstration effect models both through investments and advisory projects. Finally, WBG will continue to be selective in engaging with private sector partners who meet high standards of independence from political spheres, corporate governance, environment and social practices. IFC's advisory will promote corporate governance and highest environmental and social standards along international best practices.

49. ***Taking into account the selectivity filters described above means that some priority areas cannot be considered at this time.*** These fall into the following three categories:

- ***Areas that are identified as priorities in the Government Program and the SCD, but for which Bank comparative advantage is limited.*** An example of this is the support to the health sector, which was identified as a concern in the SCD and the “*Note d’orientation*”, but where Bank comparative advantage is limited. Furthermore, this area has been given priority in the Government’s budget - although this emphasis has been undermined by the recent increase in security-related expenses - and also receives support from other development partners such as the EU and UN agencies. Hence, this sector identified as priority for human development by the Government is likely to be funded through other means. However, the WBG ongoing policy dialogue and technical support on healthcare financing reforms will help identify an appropriate instrument with the highest value addition to be offered in the outer years of the CPF and synergies will be sought for between our support to a modernized, broad-based social protection and improvements in the health sector (see third Pillar).

- ***Areas that are identified as priorities in the SCD and the “Note d’orientation”, but where the political economy context is not conducive to reforms.*** An example of this is civil service reform which was identified as a pre-requisite in the SCD, but for which the political and social environment is not conducive at this time. While modernization of the civil service is urgently needed, the challenge is to find the appropriate timing and entry point given the overall fragility consideration. In this context, the Bank’s engagement will focus on selected technical assistance including the development of a delivery unit in the Prime Minister’s office to monitor reforms implementation, performance-based budgeting and progress towards decentralization under the second pillar of the strategy. In addition, the WBG will aim at building capacities and strengthening selected economic management institutions under sub-objective 1.1. Finally, the World Bank will provide technical assistance on the wage bill rationalization in coordination with the IMF.

50. ***To strengthen the impact of its support, the WBG will further consolidate progress achieved in the previous ISN/CPS period in five areas.*** First, the use of a systematic filtering process will allow the WBG to shift its program of support towards the most relevant areas and activities. Second, the Bank will intensify partnerships with national and international stakeholders, building on the strong coordination put in place by the Government that already exists with donors. Third, Bank lending will be substantially scaled-up compared to the ISN period and IFC investments will be in the range of US\$30-60 million per year (depending on private sector effective demand and opening of the economy), thus demonstrating a scaling-up of efforts compared to the FY11-14 average annual Bank lending of \$392 million and average annual IFC commitments of \$28 million. Fourth, a higher portion of lending will be provided in the form

of faster-disbursing investment loans (i.e., Credit Lines and Program for Results provided targeted results are achieved) to address critical reforms, institutional capacity building, and focus on results.

#### 4. B.2 Cross Cutting Themes

*Expected Outcomes:* under these two themes, the WBG expects to: (i) promote gender goals related to female labor force and economic empowerment more broadly; (ii) strengthen key public institutions of economic management; (iii) support the Government decentralization agenda; and (iv) improve access to information throughout public sector; (v) increase citizens participation in service delivery.

51. ***The gender dimension will be applied through: (i) continued gender focus of all ongoing and new operations with disaggregated gender indicators; (ii) continuing dialogue on implementation of the WDR2012 on Gender and WBG and MENA gender strategy recommendations applicable to Tunisia; (iii) raising awareness on the economic and social effects of greater gender inclusion; and (iv) strengthen the focus of potential “gender niches” in WBG operations such as microfinance,*** which have already demonstrated good results. Support under the area of youth employment will focus on the constraints young women face in accessing the labor market, and include a gender focus particularly around the planned interventions in higher education and vocational training, as well as gaining business/entrepreneurial skills. The WBG efforts will be aligned with and benefit from the strong presence in this area of UN agencies and other development partners to ensure that Tunisia is on track to reach SDG5: “Promote gender equality and empower women”.

52. ***The WB will address governance issues by focusing first on institution-building in core public sector institutions and systems.*** In addition, the issue of governance will also cut across the three pillars of the strategy and the various sectors of intervention. The Bank’s program will ensure that all sectors address governance issues. Efforts will hence focus on four areas where the Bank has comparative advantages and has been encouraged by the Government to take the lead: (i) greater government accountability and performance focus in the management of public resources including in SOEs, as well as natural assets (eg: forestry) (ii) greater fiscal transparency and access to public sector information across the public sector; (iii) citizen access to information and enhanced citizen participation policies; and (iv) strengthened governance of key public service providers, i.e. central government, local governments, as well as the private sector with a particular emphasis on strengthening financial disclosure regimes and conflict of interest regulations.

#### 4. B. 5 Objectives supported by the WBG Program

### PILLAR I – RESTORING AN ENVIRONMENT CONDUCIVE TO SUSTAINABLE ECONOMIC GROWTH AND PRIVATE SECTOR-LED JOB CREATION

*Expected outcomes:* (i) more performing institutions of economic management and stabilized macro-economic framework; (ii) tackling skills mismatch; (iii) strengthened business, trade and competitiveness environment; (iv) enabling environment for entrepreneurship and innovation; (v) modernized financial sector; (vi) private sector involvement with guarantees for transformational infrastructure projects; and (vii) continue supporting the implementation of reforms to prevent “elite capture”.

#### **Objective 1.1. Improving institutional efficiency and economic management**

53. ***The WB will have a two-pronged approach: (i) improved performance and quality of institutions of economic management; while (ii) contributing to ensure a stable fiscal and macro-economic framework.*** WBG will focus on rationalizing selected public entities by providing institutional capacity building, through training of management and staff, exchange of experiences and knowledge (including south-south participation), study tours i.e. and other capacity building interventions. In addition, the World

Bank group will continue to emphasize the critical importance of scaled-up reform oversight and communication by supporting GoT economic delivery unit in the Prime Minister's office. Ensuring macroeconomic stability in the aftermath of the recent terrorist attacks is a pre-requisite to making progress in any other area. The Government has indicated its appreciation of the support in this area provided by the Bank Group since the revolution (in coordination with the IMF, the European Union and other key donors). Against the backdrop of the weak recovery in Europe and in the context of the fiscal risks linked to increased Government spending on security, as well as economic and social development risks stemming from climate change, depletion of natural resources and regional disparities, the Bank intends to provide substantial assistance in this area, the focus of which will be adjusted throughout the CPF period to respond to evolving needs. The four areas of focus under this sub-objective will be: (i) fiscal and macroeconomic risks analysis and identification of policy responses; (ii) design of medium-term fiscal and macro-economic scenarios; and (iii) supporting the policy framework for sustainable, resilient and inclusive economic growth; (iv) ongoing dialogue with the authorities to ensure macro-economic stability.

Existing programs: (i) GOJ DPL Series (FY16); (ii) Institution of economic management capacity building TA; (iii) Investment Authority OECD-IFC project.

New programs: (i) new IBRD DPL series (FY17 & FY18) (ii) IBRD P4R on Financial Sector Modernization (FY16); (iii) IBRD AAA on subsidy reforms (FY17); (iv) IBRD TA on wage bill rationalization; and (v) just-in-time Technical Assistance.

### **Objective 1.2. Improving private sector competitiveness**

54. ***To contribute to improving Tunisia's competitiveness, WBG will focus on specific constraints affecting the development of the private sector, while continue supporting some key reforms that have greater stakeholders buy-in.*** The pre-requisite for all reforms considered under this sub-objective will be an assessment of the prevailing political and economic processes— specifically, the incentives, relationships, and distribution of power among different groups. Focus will be on: (i) improving key aspects of the regulatory environment affecting private sector development, through a combination of activities focusing on transversal issues affecting SME development, sector-specific constraints affecting selected value chains and non “spatially blind” policies resulting in distortions in areas such as agriculture; forestry, labor market and subsidy reform, which drive the economic marginalization of lagging regions; and, (ii) continuing to support trade and regional integration through existing operations including furthering procedures related to Rades port efficiency, cargo transport, customs, export regulations and VAT. The World Bank will push for drastic simplification of the pool of regulations hindering private sector activity with a view to reducing the room for discretion in their implementation is critical for a private sector-driven growth and ultimately inclusion.

55. ***The WBG will continue to pursue key reforms in Tunisia's financial sector in order to promote economic growth and employment creation.*** Interventions will aim at building a deep, diversified, and inclusive financial sector in Tunisia, through: (i) supporting the Government in the restructuring and possibly privatization of state-owned banks; (ii) expanding access to financial services for MSMEs with a focus on women entrepreneurs; (iii) strengthening selected components of the financial sector landscape (insurance, private equity, export finance and micro-finance, etc.); (iv) developing capital markets and (v) improving financial infrastructure and legal/regulatory framework (including debt resolution, credit reporting and secured lending, and digital finance); (vi) supporting regional expansion )”South-South” of Tunisian financial institutions through investment and advisory services to enable them to access markets in MENA and Sub-Saharan Africa. The engagement will target specifically financial inclusion issues for disadvantaged groups such as women, youth and rural populations.

Existing programs: (i) GOJ DPL Series (FY16), third Export Development Project; EDP3 (FY15) and Energy Efficiency operation (FY09); (ii) IBRD TA on Competitive Industries CIIP (FY13); (iii) TA on Support to Rades port efficiency and governance improvement; and (iv) Informal trade in Maghreb study; (v) MSME Development Project - Additional Financing (FY11); (vi) Financial

Sector Modernization TA; (vii) IFC led advisory services in regulatory simplification, new investment code, bankruptcy law, competitiveness law (vii) IFC investments and TA in SME banking (Amen Bank) and micro-finance (ENDA); (viii) IFC equity investments in regional SME equity funds; (ix) IFC market studies on SME Banking Services and Islamic Finance in Tunisia; (x) IFC advisory for modernization of BCT central depository and establishment of a private credit bureau.

New programs: (i) Investment Climate Update (FY16); (ii) Financial Sector Modernization P4R (FY17), new DPL series (FY17 & FY18), (iii) IFC and IBRD Investments and Advisory Services in MSMEs access to finance, financial infrastructure); (iv) IBRD political economy analysis; (v) IFC technical assistance in supporting the debt resolution and business exit legal framework; (vi) additional financing for energy efficiency (vii) IFC investments in trade finance, microfinance, SME banking, SME equity funds, specialized debt restructuring institutions, financial inclusion and financial technology related investments. More specifically, IFC will continue to support Enda Inter-Arabe to enhance its outreach to underserved segments of the population and to help it cope with a changing market environment, socio-economic and regulatory conditions and new technologies. IFC will also seek to engage with new entrants in the microfinance sector.

### **Objective 1.3. Promoting transformational infrastructure projects**

56. ***The WBG will leverage its convening power and financial resources to seek donor co-financing opportunities and private-sector financing into infrastructure, particularly ICT, water sanitation, waste management, transport, logistics and power, including through PPP.*** Using as an example ongoing efforts with bringing private sector involvement in the national sanitation utility, ONAS, and assuming removal of several key constraints and successful restructuring of the TAV concessions on Enfidha and Monastir airports, IFC and IBRD could play a significant role through both PPP advisory and investments in transport (particularly ports and logistics), ICT, energy, water and sanitation. Furthermore MIGA will scale up its guarantee support and the Bank will reinforce its upstream work on the enabling environment in order to attract the private sector. Finally, the World Bank Group will continue to promote improving financial sustainability and operational efficiency of SOEs through increased cost recovery, tariff policies, subsidy reforms and performance improvement. It will promote the financing of public sector infrastructure necessary to attract private sector investment (port and logistics). In order to support these initiatives, the WBG will encourage social accountability mechanisms involving citizen participation, especially among youth groups.

Existing programs: (i) Urban Water Supply Project (FY05) and additional financing (FY14); Northern Tunis Wastewater Project (FY10) and additional financing (FY15); (iii) Pilot public-private partnership (PPP) program to a) professionalize rural water supply services TA, and b) to identify potential PPP projects in Transport (Public Private Infrastructure Advisory Facility (PPIAF)); (iv) Institutional Strengthening for Transport Sector Sustainability ESW; (v) road safety study; (vi) IBRD/IFC Arab Financing Facility for Infrastructure (AFFI) and PPIAF funded TA activities with public utilities SONEDE and ONAS; and (vii) TA on feasibility of importing natural gas.

New programs: (i) Digital Tunisia - Accelerating High-Speed Internet Access project (FY17); (ii) IBRD analytical work (Road maintenance study – FY16); (ii) IBRD Technical Assistance (Urban Transport, ICT, Ports); (iv) IBRD sanitation PPP investment fund and Partial Risk Guarantee (PRG); (v) Pilot public-private partnership (PPP) program to professionalize rural water supply services TA; and (vi) IFC potential advisory and investments in ports, energy, ICT, water and sanitation, and logistics.

## **Pillar II – Reducing regional disparities**

*Expected outcomes:* the WBG expects to support GoT's goal to reduce the gap in economic opportunities and living standards across regions, by: (i) improving delivery of social and economic services; (ii) improving quality and access to infrastructure and services; and (iii) improving connectivity between leading and lagging regions.

### **Objective 2.1. Narrowing the gap in basic social and economic services**

57. *The WBG will support Tunisia as it implements its decentralization agenda.* The Bank's engagement will focus on supporting GoT efforts to establish a performance-based fiscal transfer system, strengthening the capacity of central government agencies to support and oversee the performance of local governments, strengthening the back-office functions of local government to deliver local services and infrastructure, and developing tools for citizens to monitor local service delivery. WB financial support will promote gradual roll out of performance incentives in fiscal transfers to local governments for priority sectors (infrastructure, health and education). In tandem, IFC would help support private sector models of delivering some of the services. In order to help GoT increase female participation in local government an emphasis will be placed to promote women participation in municipal councils. Narrowing the welfare gap between leading and lagging areas requires tailored approaches to rural and urban service delivery. Given the scale of the problem this area acknowledges the need for different approaches in urban and rural areas and seeks to have interventions focused around three types of local delivery areas: (a) very large metropolitan areas which provide a high percentage of national economic activity, (b) rapidly urbanizing secondary cities and (c) rural and deprived areas. In rural lagging regions, the majority of jobs are in agriculture. In the agricultural sector, the Bank will continue improving farm or off-farm related livelihoods and job creation. The Bank will continue to support Government efforts to infrastructure and service-delivery issues. In the water sector in particular, the Bank will continue to provide support to ensure water security in a context of climate change and growing demands; to strengthen public investment patterns; help redefine pricing, quality of services; respond to rural access deficit in sanitation; and address institutional framework and financial sustainability problems for water, sanitation, rural and urban utilities. Community-based maintenance schemes for rural infrastructure will also be explored to ensure the sustainability of such investments and create employment opportunities for the rural poor.

Existing programs: (i) ongoing JSDF and GEF grants (Ecotourism and Conservation of Desert Biodiversity, JSDF Emergency Support for Youth, JSDF Community Works/ Local Participation); (ii) IBRD analytical work on decentralization; (iii) ongoing IBRD investment (fourth phase of the North West Development Project and Second Natural Resource Management Project); IBRD ESW Agriculture Dialog; ); (iv) Urban Development and Local Governance Program (FY14); and (v) a new Integrated services operations that addresses the needs of the lagging regions.

### **Objective 2.2. Improving connectivity between lagging and leading regions**

58. *The WBG will support GoT's efforts to reduce regional disparities by focusing on improving connectivity and logistic infrastructure to better connect lagging and leading areas.* In Transport, the CPF activities will focus on improving rural-urban linkages by (i) improving the road network infrastructure to reduce transport costs and mitigate externalities such as road fatalities; (ii) strengthening the institutional capacity of road and urban transport institutions in planning, managing and maintaining transport assets and services; and (iv) improving road safety. In ICT, the World Bank will support the implementation of the Digital Tunisia national strategic plan which promotes "Broadband for all" using the existing universal service fund ("*Fonds de Développement des Télécommunications*"). In ICT, IFC will continue to support the ICT federation to improve youth employability in the ICT sector through its E4E Initiative for Arab Youth project (cf objective 3.2) and to actively seek investment opportunities with regional players like SAB Mediterranee. IFC will also seek to co-finance alongside IBRD the private sector led component of the "Tunisia Digital" project.



Existing programs: (i) IBRD investment Road Transport Corridors, incl. TA component (FY16); (ii) IBRD TA on ICT (FY15); (iii) IFC regional investment in SAB which covers Tunisia.

New programs: (i) Digital Tunisia - Accelerating High-Speed Internet Access in Tunisia (2016), (ii) technical assistance for transport sector sustainability (FY17 or FY18), and (iii) IFC investments.

### **Objective 2.3. Enhancing economic opportunities in selected regions**

59. *The WBG will support GoT in devising and implementing a more integrated approach to regional development, focused on sustainable economic activity (in sectors such as agriculture, forestry, water and ecotourism), private sector involvement and local governance reforms.* To achieve this objective, a joint WBG/Government task force will be created. Investments in high-priority local infrastructure will be combined with a) enhanced local governments' service delivery and spatial planning capacity, also thanks to participatory governance reforms; b) improved management of natural assets (e.g., forestry, rangelands, fisheries) which impacts local population<sup>11</sup> (notably women) and private sector, and poses serious risks to water availability and downstream infrastructure (dams, roads) notably in the context of climate change; c) identifying value-chain interventions in growth sectors conducive to job creation such as agribusiness, eco-tourism, agro-forestry, light manufacturing; c) accelerating the growth of regional clusters of firms and industries (e.g. fisheries, agro-business and naval industries in Bizerte and Tabarka). In the CPF outer years, the WBG could support an investment project in selected regions piloting this integrated approach in 1 or 2 regions building on the ongoing dialogue on lagging regions.

Existing programs: (i) IBRD AAA on Mapping Value Chains, Jobs and Sectorial Constraints to Growth in Lagging Regions; (ii) IBRD AAA on Green Growth and Landscape Management; GEF Grant (DELP Oasis Ecosystems and Livelihoods); (iii) IFC investment in olive oil producer CHO; (iv) IFC investment and advisory support to ENDA to finance farmer's "micro-equity" investments in new cows.

New program: (i) Tunisia interior regional economic development ASA (FY16); (ii) potential IFC investments in agribusiness and other relevant industries with strong value-addition and impact on their value chain in selected lagging regions; (iii) IBRD Forestry value-chains project (FY17); and (iv) potential IFC investments in the financial sector (in particular micro-finance) with a specific focus and impact in selected lagging regions.

## **Pillar III - Promoting increased social inclusion and reducing fragility with an emphasis on youth**

*Expected outcomes:* WBG will support the Note d'Orientation third pillar relating to social inclusion and reduced fragility as it makes strides to break away from past practices through: (i) increased citizen involvement, particularly youth, in public affairs and development activities; (ii) WBG broader engagement with all stakeholders; (iii) strengthened citizens accountability mechanisms; (iv) increased access to finance, essential information and services, and positive media/messaging and networks, particularly for young people; (v) reduced vulnerability for groups at risk (improved coverage of safety nets); and (vi) increased resilience to Libya's conflict spillovers.

### **Objective 3.1. Promoting voice, participation, transparency and accountability**

60. *Through innovative approaches, the WBG will support GoT's commitment and efforts to promote access to information, disclosure of Government information and citizen engagement (in particular in implementation and evaluation of investments).* WBG will seek to take into account IEG recommendation for broadening its stakeholder base. To facilitate public discussion on key policy reforms,

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<sup>11</sup> Forests and rangelands contribute to over 50% of the revenues of poor rural households.

the Bank will support the production of media products on key issues to be used in public fora. These will particularly focus on ongoing and planned economic reforms and the medium-term positive effects on its citizens: labor market reform and the challenge of job creation; pensions reform and implications for the next generation; the investment incentives code and opening up to foreign investment; the cost of cronyism, and regulatory red tape; food and fuel subsidies and the social protection system. Opportunities for youth to engage constructively and actively in the design, implementation, monitoring and evaluation of investments will also be sought.

Existing programs: (i) TA National Network of Social Accountability; (ii) Regional access to information workshop; (iii) Parliamentary Strengthening in Tunisia and Morocco; and (iv) Governance in Social Sectors Technical Assistance.

New program: (i) IBRD political economy analysis (FY16); (ii) IBRD communicating for reforms TA; (iii) Analysis of the Budget (ESW); and (iv) Platform for CSOs.

### **Objective 3.2. Fostering opportunities for Youth**

61. ***The WBG will promote youth inclusion through interventions targeting youth employability that foster entrepreneurship and innovation.*** The WBG will seek to support entrepreneurship development by improving access to finance, encouraging concept development and commercialization of new ideas (via business plan competitions and grants at seed/early stage), supporting the different players in the entrepreneurship ecosystem (incubators, accelerators, angel investor community), and providing mentoring, coaching and networking opportunities to entrepreneurs, and mobilizing Tunisians living abroad to support young entrepreneurs and invest in Tunisia. This engagement will be driven by the findings of the World Development Report 2013 on jobs and the 2013 report on “*Breaking the Barriers to Youth Inclusion*” which provides an analysis of the aspirations and needs of young Tunisians, taking into account both non-economic and economic measures of exclusion. The Tunisia Youth Inclusion ESW developed in the ISN period provides ample data and evidence on youth economic, social and political exclusion, as well as comprehensive sets of measures to address it. The WBG will remain involved in the education through analytical work, policy dialogue and targeted financial support. The Bank has consistently supported the education sector in Tunisia since the 60’s (Tunisia has benefited from the 1st IDA grant to education). Over the past years, dialogue has mostly focused on higher education for employment through the recently closed PARES2 project and reforms related to higher education institutions increased autonomy under the GOJ DPL.

62. ***The WBG will remain involved through analytical work and policy dialogue in the entire education sector*** (ECD, primary and secondary, vocational and higher education) with an objective of improving quality, relevance and governance of education and promoting public-private partnership for all aspects of education. The WBG will support specific interventions aiming at improving the quality of education and youth employability through the Tertiary Education and Employability Project (TEEP), the Accelerating High-Speed Internet Access project (see objective 2.2) and the WBG-IsDB regional Education for Competitiveness program (E4C). TEEP activities will consist of support to university management including increased autonomy, incentives-based financing and fostering effective partnerships with private sector to enhance employability of future graduates. IFC will continue to focus on developing skills in the ICT sector, with potential additional work into other growth sectors identified as facing skills constraints, including construction, tourism, and electro-mechanical industries.

63. ***Through new interventions, the WBG will seek to upgrade parts of the entrepreneurship ecosystem.*** The focus under this area will be four-pronged: (i) to guide the education system toward entrepreneurship (see 1.2); (ii) provide training and support on business skills and entrepreneurship to youth and women, including in lagging areas, through IFC’s E4E FAST program; (iii) to make GoT more responsive to private sector employment needs; (iv) to facilitate innovation in key clusters with economic potential; and (v) to create a diversified and efficient financial system. IFC and the World Bank will work

closely with financial institutions (banks, leasing companies, SME equity funds and microfinance institutions), through financing (mostly risk sharing facilities, trade lines, loan and equity investment) as well as advisory services by promoting MSME finance, deploying capacity building products and further developing leasing products in order to ease MSME's access to equipment. To complement these structural interventions, a multi-faceted media strategy will be developed to facilitate behavior change amongst target populations, thereby making entrepreneurship and innovation careers more appealing (e.g., through showcasing role models). They will specifically target unemployed youth and women by providing market-relevant skills and opportunities to develop entrepreneurship. The WBG will support the mobilization of funds to enhance entrepreneurship opportunities. In addition, this expected outcome area will be supported by the CPF engagement in Social Protection and Labor, especially to direct attention to the lower skilled youth and to offer support for a more integrated approach to skills development.

Existing Programs: (i) IFC E4E Initiative for Arab Youth; (ii) IBRD AAA (Employment TA Package); (iii) IBRD Third Competitiveness and Export Development Project -CEDP3 (approved date 2014); (iv) IBRD MSME Development Project and additional financing; (v) IBRD MSME TA; (vi) JSDF Emergency Support for Youth (approved April 2012); (vii) Dissemination of evidence on the medium-term impacts of entrepreneurship education for university graduates (Business Plan Thesis Competition); (viii) Dissemination of ESW Breaking the Barriers to Youth Inclusion; and (ix) TA to establish formalized national youth council..

New programs: (i) IBRD Tertiary Education for Employability Project (TEEP), (FY16); (ii) IBRD AAA on private sector needs and mapping of key sub-sectors and value-chains; (iii) WBG-IsDBG regional E4C program; (iv) IBRD AAA to support education reform for youth employability; and (v) IBRD ESW Youth Analysis follow-up; (vi) and IBRD IPF and TA to support entrepreneurship development; (vii) Business Competition.

### **Objective 3.3. Facilitating the renewal of social contract through improved and more equitable social services**

64. *The WBG will support the transition towards more effective, efficient and equitable social services. The pre-revolution social contract failed to protect the poorest and the most vulnerable, and to ensure equal opportunities to all Tunisians.* Considerable disparities in poverty rates persist between regions, and between urban and rural areas and age groups. Inequality of opportunity is also significant, in health and education. In the short term, and in the face of the deterioration of economic and social indicators and possible subsidies reform, the WB will continue its support to the GoT in the development of better targeted, more responsive safety nets with greater coverage; enhancing the coverage and sustainability of the pension system, and will level up its policy dialogue to address inequality of opportunities in access to basic education and health services, particularly in lagging regions. Regarding the longer term agenda, the WB will focus on developing foundations of more effective, efficient and equitable social sectors in four core areas: (i) a renewed targeting system built on a robust social registry and a more efficient and coherent system of safety nets, building on the recently completed reform of a national unique identifier and supporting the development of a “common social identifier” to reduce fragmentation of safety nets; (ii) a more productive emphasis of safety nets, setting the foundations for a renewed contract between users/beneficiaries and the state, exploring changes in investments in education, more healthy behaviors, and linkages with skills-development opportunities through a greater connection with the supply of opportunities in this area; (iii) a more comprehensive and financially sustainable pension system that provides old age security and enhance equity in resource utilization (iv) education and health strategies and programs aiming at ensuring equal opportunities of access to quality services, developing approaches to sustain these programs and improving governance and accountability mechanisms as part of the new social contract, including the development of ECD and promotion of positive discrimination in favor of lagging regions and disadvantaged groups; and (iv) social security financing reform, including pensions and health insurance and the design of unemployment insurance. Finally, the WB support in this area will offer an opportunity to promote synergies between the gradual reform of the safety nets and the reduction of access

gaps to quality education and health services and a gradual change of culture in the delivery of social assistance.

Existing programs: (i) Transition Fund Project on Support to Social protection reforms (FY14); (ii) SABER benchmarking of ECD policies and programs (FY16); (iii) Community health JSDF grant; and (iv) IFC's equity participation in Amen Santé clinics.

New programs: (i) IBRD multi-sectoral Programmatic DPL (FY17 or FY18); (ii) Programmatic AAA on modernization of the SPL System and support to inclusive education and health policies.

### **Objective 3.4. Reducing fragility through renewed regional integration**

65. ***In line with the objective of the MNA Regional strategy, the CPF will aim to provide a stronger and more strategic framework for a regional approach to fragility.*** The Framework will aim at facilitating cross-border trade through development of infrastructure links and trade facilitation. The World Bank will also support Tunisia in assessing and providing a well-targeted response to the impact of the Libyan crisis. Trade between Tunisia and Algeria will also be supported through technical assistance to support trade facilitation and customs collaboration, as well as infrastructure investment in the road sector. In the short term, the Bank technical assistance will continue to focus on informal sector and tax implications of cross-border trade. The Bank is carrying out an assessment of the impact of the Libyan crisis on service delivery, services and subsidized goods consumption as well as in some sectors, particularly tourism; on financial flows, remittances; and trade and potential mitigation measures. Regional integration will continue to be promoted by improving the management of shared natural ecosystems, and risks of coastal zones resulting from un-coordinated development, population pressures, climate change and sea level rise.

Existing program: (i) Informal trade in Maghreb study; (ii) MENA Regional Desert Ecosystems and Livelihoods Program (DELP); (iii) IFC investments in regional private equity SME funds operating in MENA and Maghreb, e.g., MPEF II and III funds (managed by Africinvest), ANAF II fund (managed by Abraaj), INTAJ II fund (managed by Swicorp), CNAV II fund (managed by North Africa Capital Partners)

New programs: (i) ESW on Libyan crisis impact (FY16); (ii) cross-border transport and trade facilitation project (Tunisia/Algeria) (FY17); (iii) regional ASA and project on integrated, sustainable coastal zone management; and (iv) potential IFC South-South investments across key sectors wherever opportunities arise.

## **C. IMPLEMENTING THE COUNTRY PARTNERSHIP FRAMEWORK**

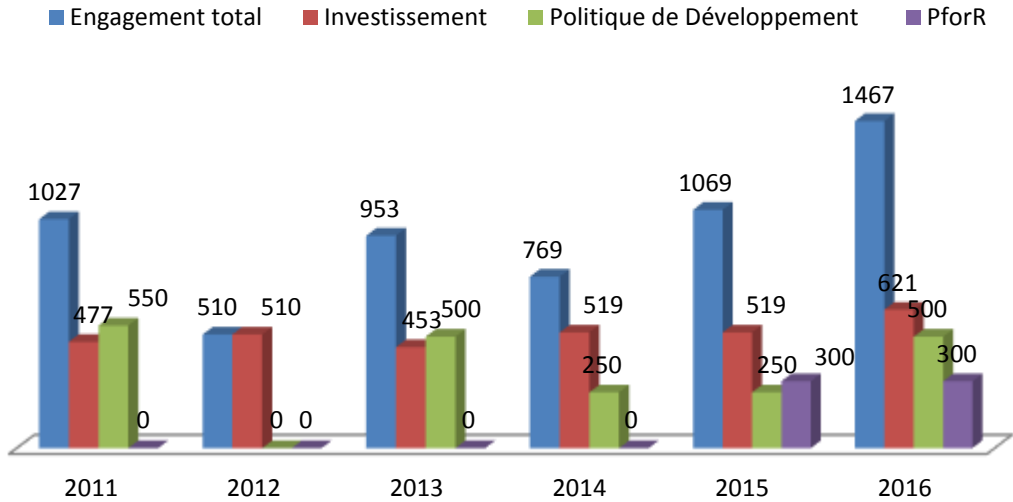
66. ***Proposed new approach of looking at institutions and political economy.*** This CPF proposes to mainstream governance and politically savvy thinking into the core business of the World Bank Group so that, context, institutions, and incentives are factored into Bank thinking throughout project design. The WBG will innovate with new instruments to strike right balance between technical desirability and political feasibility. The proposed “governance filter” will probe key factors of the Tunisian context likely to affect effectiveness of operations. In cases, where sufficient attention has not been provided to the political economy context of an operation, and risks to not achieving development outcomes are high, the Governance team could support other GPs in understanding sector and project specific political economy work. Existing and pipeline operations will leverage, where relevant, the on-going governance reform levers, for instance on transparency and access to information, on public consultation, SOE governance, public financial management on procurement. This would be in order to maximize synergies, better align incentives and strengthen the sustainability and development outcomes of the World Bank program in Tunisia.

### **Box 3: What the World Bank Group will do differently in Tunisia**

- **Greater assessment of the political economy of reforms.** Use existing and new analytical work to inform economic reforms’ feasibility, pace, and CPF potential impact.
- **Greater focus on those left behind.** Especially the youth and lagging regions;
- **Increased focus on civil society.** Promote the role of Civil Society in holding the Government accountable.
- **Greater balance between flexibility and reputational risk.** Ensure the Bank’s credibility and success of reforms;
- **Continued joint IBRD-WB-IFC and cross Global Practices solutions.** Joint solutions in key sectors such as water and financial sector.

67. *Country demand for borrowing from IBRD during the CPF period is estimated at up to US\$5 billion, with an additional \$150-300 million expected from IFC to support the private sector assuming improvements in the investment climate that will generate increased investor interest.* The overall financing envelope for the Bank’s engagement in Tunisia is expected to be substantially higher than that for the ISN period. The Bank FY16 and FY17 pipelines are respectively estimated at \$1.5 billion (of which \$500 million in development policy lending, \$550 million in PforR, and \$395 million in investment project financing) and \$1.3 billion (of which \$500 million in development policy lending, \$200mn in PforR and \$650 million in investment project financing), respectively, while IFC expects to commit about 40-60 million in FY16 on the assumption that the environment for private sector improves. Lending volumes in FY18-20 will depend on country performance, improvements in the investment climate and investor sentiment, IBRD’s lending capacity, demand by other Bank borrowers, and global economic developments. This level of financing is considerably more than what was made available to Tunisia over the past five years (FY11-15), which was just over US\$1.8 billion.

**WB commitments in Tunisia FY11-FY16**



**Box 3: Aid Coordination and Harmonization in the CPF**

Efforts towards aid coordination and harmonization have taken many forms in Tunisia. The CPF intends to support Government efforts, particularly those of the Ministry of Regional Development and International Cooperation, to coordinate assistance from partners with enhancing the effectiveness of sectoral policies.

- **Economic Reforms:** Coordination and joint operations in five areas: improvements to the business environment, competition policy, commercial policy, optimizing financing of the economy and reform of the financial sector (including European Union, DFID, IMF, and AfDB).
- **Governance:** Coordination on legislative, institutional and administrative reforms (including EU, AfDB, WBG).
- **Infrastructure:** Programs to upgrade basic infrastructure in lagging regions by AfDB and EU.

- **Energy:** Coordination on promoting an enabling environment for renewable energies and energy efficiency (including GIZ, EU, and AFDB).
- **Education:** Donors support to developing education and training, higher education and scientific research (including EU, UNESCO, AFDB, and OECD). However, coordination could improve.
- **Employment:** Programs targeting access to employment by developing skills in regions (including EU, AFDB, and GIZ)
- **Water:** Projects geared toward improving access to drinking water and irrigation for agriculture (including AfDB, BAD, GEF, and WBG)
- **Microfinance:** Financial Inclusion: Joint programs to support legal and regulatory reform for microfinance development (GIZ, ADA, European Investment Bank), cooperation on developing financial infrastructure to support inclusive finance (credit bureau, national observatory, professional association), cooperation on liquidity support to support greenfield MFIs and sectorial expansion (European Union, World Bank, ADB). There is also a donor committee which meets periodically to oversee coordination and determine how to best leverage resources. This committee has most recently been working with authorities on launching a national financial inclusion strategy.

68. ***Supervision of ongoing activities will remain a priority for both IBRD and IFC. The WBG's contribution to results of the CPF will primarily come from the existing portfolio.*** The existing portfolio will be adjusted to the CPF objectives through a “retrofitting exercise” to ensure development objectives are aligned with the three objectives of the CPF. Tunisia’s portfolio with a net commitment of US\$1.4 billion includes a US\$500 million Development Policy Loan approved in October 2015, a US\$300 million Program for Results (P4R) operation supporting municipal services, approved in July 2014 and nine SILs operations totaling US\$621 million. The portfolio is 82% undisbursed. In addition, it also includes 14 grants, representing commitments of US\$46 million. A “deep dive” exercise is underway to assess implementation bottlenecks with a focus on increasing the likelihood that projects will achieve their development objectives on the prevailing political economy context.

69. ***The 2011 Revolution had a direct impact on portfolio performance resulting in disbursements and results slowdown. Portfolio trends have however started to recover during FY14/FY15.*** While lending initially peaked in FY11 with the approval of the US\$500 million Governance and Opportunity DPL and US\$50 million MSME Financing Facility, no IBRD commitments were registered in FY12. In FY13, commitments began to climb again as the economic reform program moved forward and the Governance, Opportunities and Jobs DPL series became active. During FY14, new investment lending operations were approved. In early FY15, a US\$300 million Urban Development and Local Governance operation was approved by the Board, using the new Program for Results (P4R) lending instrument.

**Table 3. Tunisia IBRD Portfolio Highlights**

	FY09	FY10	FY11	FY12	FY13	FY14	FY15
<b>IBRD Portfolio and disbursements</b>							
Active projects (#)	17	17	17	17	16	20	20
Annual Lending Commitments (\$m)	371	88	592	50	500	427	300
Net commitments (\$m)	865	864	1,016	546	492	820	1,119
Undisbursed balances(\$m)	602	471	829	346	273	615	643
Disbursements in FY (\$m)	56	206	65	30	67	37	268
Disbursements ratio (%)	18	27	20	11	20	15	6
Slow disbursements (%)	31	38	13		15	7	20
Note: No of projects, disbursements and commitments include small RETFs <\$5m, all other indicators excludes small RETFs.							
*Reflects slippages of GOJ DPL3 and other lending operations to early FY16.							

70. ***Since 2011, IFC ramped up its investment services in Tunisia with a strategy of restoring investor confidence and facilitating private sector led growth and job creation.*** More investments have been committed since the Tunisian Revolution (January 2011) than in the ten years before the Revolution. As of August 2015, IFC total committed investment portfolio was \$315 million, including \$126 million mobilized from other investors (AMC & B lenders). In terms of number of investment clients (total 9), the portfolio is diverse, with investments in transportation (airport), SME banking, SME private equity funds, microfinance, automotive industry, oil and gas, agri-business and health care. In FY15, 4 new investments were committed, including 2 regional private equity funds, a regional ICT company and one Tunisian agri-business company. FY16 high probability pipeline includes 4 new investments in micro-finance, industry, debt restructuring and banking.

71. ***Between 2011 and 2014, the Bank carried out high quality analytical work in many sectors and provided technical assistance using Bank budget and trust fund resources.*** Major reports included a 2013 Development Policy Review (The Unfinished Revolution: Bringing Opportunity, Good Jobs and Shared Prosperity), a 2012 study on the status of Informal Economy in Tunisia, and a 2014 report on elite capture (“All in the Family, State Capture in Tunisia”). Many trust funds were mobilized to support areas where the Bank is engaged, improve capacity building and pilot innovative approaches for youth, social services and natural resource management. IFC has stepped up its advisory support in Tunisia and has been working closely with the Bank, especially in the area of investment climate reforms and access to finance for MSMEs. IFC has rolled out the E4E Initiative for Arab Youth, an investment and advisory program which aims at improving youth employability. Currently, this initiative includes partnerships with public and private universities, business associations, and training institutes enhance competencies and employability catering to the needs of growing sectors such as ICT.

72. ***Despite an improvement in Tunisia’s active portfolio in FY15 in terms of volume and indicators, annual disbursements remain modest.*** While increased commitments, fewer projects rated unsatisfactory and greater proactivity have characterized the FY15 portfolio, the yearly disbursement ratio from 2011 to 2014 had averaged a modest 16 percent (albeit above the regional average of 13 percent for that period). Tunisia has also historically experienced long delays in projects effectiveness and implementation, the latter due to cumbersome Government procurement procedures and human resource challenges.

73. ***During the CPF period, readiness for implementation will be ensured through the systematic use of a readiness filter.*** The use of a filter, building on the MNA region Quality of Entry requirements would improve project performance. The key filters to proceed with negotiations are as follows: simple projects with a limited number of procurement contracts; draft bidding documents reviewed and agreed upon; implementation modalities discussed and operational manual agreed-upon; key project staff, including fiduciary staff; annual procurement plan and work program agreed upon.

74. ***During the October 2014 CPPR, two broad areas to improve portfolio performance were identified.*** Project management and efficiency of the PIUs; and fiduciary issues (including procurement and financial management) were identified as areas of focus. Based on in-depth interaction with the Bank’s teams and Tunisian counterparts, an action plan was prepared to address key issues and bottlenecks. While many of the actions are quite simple, they require close oversight, from ensuring adequate staffing of fiduciary staff fully dedicated to projects; to including fiduciary specialists in supervision mission discussions; or, providing adequate training of PIU staff on Bank fiduciary procedures to ensure that procurement procedures are followed according to loan agreements. In addition, the Bank established a virtual implementation platform between PIU staff to share best practices and troubleshoot on common fiduciary issues.

75. ***A joint World Bank-Government portfolio “deep dive” exercise is under way with a core WB/GoT team in place.*** The objectives are to ensure that: (a) all ongoing projects are likely to reach their development objectives within the timeframe; (b) identify factors affecting low disbursement rates; (c) assess the extent to which fiduciary procedures have a negative impact on disbursements and achievements

of development objectives; (d) assess the impact of safeguards policies with emphasis on land acquisition; (e) assess project implantation units capacity; and (f) suggest actions to improve projects performance.

76. ***MIGA's portfolio in Tunisia, a member since 1988, is the fourth largest in MENA***, with a gross exposure of US\$125 million as of end-October 2015 in one active guarantee in the transport sector. MIGA also supports US\$5.4 million of outbound investment from Tunisia. MIGA's consistent support to foreign investors at a time when the political risk insurance industry's capacity for Tunisia had been constrained, contributed to send a strong signal that MIGA is open for business in the country.

#### **IV. MANAGING CPF PROGRAM RISKS**

77. ***The WBG's new framework for operations risk management is based on the principle that risks should be assessed based on their impact on CPF results and ability to achieve the twin goals.*** A core element of the new approach is to develop and regularly update operations risk ratings by using the Standardized Operations Risk-rating Tool (SORT – see ratings per category in table 3 below), which will be used proactively in reviews and decision-making processes.

78. ***The overall risk to the successful implementation of the CPF program is assessed as high.*** The CPF program faces four types of risks: i) security; ii) capacity; iii) political stability; and iv) macroeconomic.

79. ***Security remains the largest external risk.*** During the CPF period, domestic and regional security is likely to remain volatile as Tunisia will continue to be targeted by extremist groups. While the WBG remains committed to supporting implementation in all regions and development efforts are vital to strengthen security, a significant deterioration in security conditions if affecting the effective roll-out of the program in parts or the whole territory would lead the a review of current arrangements. In such a situation, the WBG would discuss and agree with the Government on how to proceed in affected zones. A Security Officer, in charge of monitoring the security risks, will be based in Tunisia from January 2016 onwards.

80. ***Besides the security risk, three other major risks could impact on the program:*** (i) weak institutional and implementation capacity; (ii) political economy and governance challenges; and, (iii) uncertainty around the global, regional and local macroeconomic environment. These risks, if materialized, could singly or jointly impact the Government's ability to implement reforms and projects necessary to support its ambitious 2016-2020 development agenda. They also pose a challenge to the country's capacity to attract private sector investments.

##### **(i) Institutional capacity for implementation and sustainability risk**

81. ***Institutional capacity of Government at all levels remains weak.*** Government's capacity to sustain the level of donor-funded interventions could adversely affect the achievement of the CPF development objectives. Government capacity is weaker than before the 2011 Revolution as illustrated by growing risk-aversion, slow decision-making, and weak Government systems for absorbing external financing for investments and lack of accountability.

82. ***The WBG has carefully assessed this risk and put in place concrete mitigation measures to minimize its impact on CPF implementation.*** First, this streamlined CPF includes large scale transformational projects with limited tenders. In addition, by putting the engagements through a thorough political economy filter, the WBG is less likely to concentrate on areas where there is insufficient political buy-in or limited potential for success. Secondly, in sectors where the private sector should be driving development, the IFC will be asked to take the lead and the IBRD will only come-in as "*financier of last resort*". Thirdly, by using a multiplicity of tools to implement the program, including a combination of development policy lending, investment and results-based financing and analytical work, the WBG will be better equipped to address the challenges and demonstrate impact and results. Bringing in public and private



partners whenever possible (including development partners, CSOs and academia) will help encourage greater Government accountability for project implementation. Finally, at the project level, a “*readiness for implementation filter*” will be strictly applied minimizing procurement and ensuring that bid packages are ready-prior-negotiation as Government procurement is a key bottleneck.

**(ii) Political economy and governance**

83. ***Lack of progress on key governance reforms.*** As previously noted, the SCD highlighted that improving governance is critical for achieving sustainable growth and reducing poverty. The Tunisia economy is still functioning along pre-revolution model hamstrung by heavy state regulation with elite-capture and cronyism as norms. The GoT will continue to find it difficult to introduce and enforce significant reforms because of obstruction from vested interests, poor institutional arrangements, and an over-centralized, top-down governance model that has fueled the parallel economy. A failure to follow through with reforms planned under the CPF will impact our ability to help the Government with its very ambitious plans to shift its economic model to private-sector led growth.

RISK CATEGORIES	H: High; S: Substantial; L: Low
Political	H
Governance	H
Macroeconomic	H
Sector strategies and policies	S
Technical design of project or program	L
Institutional capacity for implementation and sustainability	H
Fiduciary	S
Environment and social	S
Stakeholders	H
<b>Overall</b>	<b>H</b>

**Table 3: SORT –Ratings per Category**

assistance are intended to mitigate this risk. Though larger than expected negative shocks, such as a fall in remittance inflows, only a mild recovery of foreign direct investment inflows, or a drop in external demand for Tunisian exports could undermine the results of these mitigating efforts.

84. ***These risks can only be partially mitigated.*** Yet, the WBG believes that these reforms are so fundamental to achieving the twin goals and the future of Tunisia that it merits inclusion in the CPF and perseverance. If, during the CPF period we assess that making an impact is no longer viable, we expect to withhold or delay upcoming budget support operations and draw back from some areas.

**(iii) Uncertainty around the global and local macroeconomic environment**

85. ***The Systematic Country Diagnostic highlighted Tunisia’s vulnerability to economic shocks as its economic fundamentals remain fragile.*** The fiscal room for maneuver is less than in the past given the shocks to key sectors of the economy such as Tourism and the uncertainty of Eurozone growth. If the macro-economic risk materializes, it could potentially delay the implementation of reforms and slow economic growth in the next few years. For the Bank, it could mean delays in budget support to influence reforms to support the CPF results. The current program supported by a Stand-By Arrangement (SBA) (with the International Monetary Fund) as well as the ongoing dialogue (with the World Bank and other donors) providing budget support and technical