



# Program Information Document (PID)

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Concept Stage | Date Prepared/Updated: 21-Aug-2018 | Report No: PIDC168310



**BASIC INFORMATION**

**A. Basic Program Data**

Country Tunisia	Project ID P162165	Parent Project ID (if any)	Program Name Tunisia Water Sector Reform Project
Region MIDDLE EAST AND NORTH AFRICA	Estimated Appraisal Date 27-Nov-2018	Estimated Board Date 20-Dec-2018	Does this operation have an IPF component?
Financing Instrument Program-for-Results Financing	Borrower(s) MDICI	Implementing Agency SONEDE	Practice Area (Lead) Water

**Proposed Program Development Objective(s)**

To improve SONEDE’s financial and operational performance and the quality of service to customers, and to secure water supply in Greater Tunis and diminish losses in selected Central and Southern Governorates.

**COST & FINANCING**

**SUMMARY (USD Millions)**

<b>Government program Cost</b>	300.00
<b>Total Operation Cost</b>	150.00
Total Program Cost	150.00
IPF Component	0.00
Other Cost	0.00
<b>Total Financing</b>	150.00
<b>Financing Gap</b>	0.00

**FINANCING (USD Millions)**

<b>Total World Bank Group Financing</b>	150.00
World Bank Lending	150.00



<b>Total Non-World Bank Group and Non-Client Government Financing</b>	150.00
Private Capital and Commercial Financing	150.00
of which Private Capital	150.00

## B. Introduction and Context

### Country Context

1. Tunisia is a middle-income country of 11.4 million people with an average gross domestic product (GDP) per capita of US\$3,700 in 2016. In the last decade, economic growth averaged 5 %, positioning Tunisia among the fastest growing countries in the MENA region. The country has also made significant progress in the fight against poverty, with the poverty incidence halving between 2000 and 2015, from over 32 % to 15 %, and extreme poverty also halving during the same period. Regional disparities have been a long-standing challenge, with the North West and Center West showing rates almost twice the national average. Inequality, as measured by the Gini index, is estimated at 31%, down from 36% in 2005. Tunisia has now entered a new political era under the Second Republic after adopting a new constitution and holding its first democratic elections for a new President and a new People’s Assembly elected for the 2015-2019 period.
2. Despite these achievements, the socioeconomic challenges remain substantial. In recent years, social and political turmoil led to an economic slowdown, as GDP growth declined from an average of 3.2% between 2006 and 2016, to 2% in 2016. It is projected to expand modestly to 2.7% in 2018. Unemployment is high at 15.5% in aggregate in 2017 despite a low labor force participation, at about 50%, mainly due to weak participation of women (28%). The fiscal deficit was contained below 5% of GDP in 2015, thanks to the sharp drop in international oil prices and de facto lower energy subsidies. Public expenditure remained dominated by recurrent spending, including a wage bill which increased to 13.4% of GDP (from 12.8% in 2014) to reach almost 50% of total spending. Capital expenditure continued to be squeezed, reflecting slow investment execution.
3. The Government of Tunisia (GoT) controls state-owned enterprises (SOEs) in productive and service sectors, employing 4.5% of the active population – with an increase of more than 50% since 2011 as a response to continuous social discontent. The growing deficit - representing 4.4% of GDP (non-financial SOEs) in 2013 - has significantly increased the transfers to these entities from about 2% of GDP in 2010 to 7% in 2013. In 2015, the external debt of SOEs guaranteed by the GoT reached 12% of GDP.
4. Against this backdrop, there is an urgent need to improve the governance and performance of SOEs. A vicious circle exists between the GoT and many SOEs, in which SOEs are given very limited administrative and financial autonomy, which constrains their ability to raise revenues or control costs, thus putting them in a delicate financial situation. In response, the GoT is obliged to increase ex-ante control mechanisms, thus exacerbating the lack of accountability, which results in a need to increase subsidies and recapitalize SOEs. The outdated legal framework within which SOEs operate accounts for much of this dysfunction, as it restricts and slows internal decision-making. A “Reform Strategy



for SOEs” was approved by the Council of Ministers in November 2015 to increase the accountability between the GoT and SOEs but is yet to be fully implemented.

5. Tunisia has recently strengthened its public-private partnership (PPP) legal and institutional framework and intends to use this modality more often in the development of its infrastructures. The historical record on PPPs is generally quite modest and reflects a historical preference for a public-sector provision of infrastructure services driven by strong access to concessional lending. In the drinking water sector, no PPP transaction has been signed so far, but the Government and SONEDE intend to construct the next important desalination plant (in Mahdia) through a build-operate-transfer (BOT) scheme. A new PPP law was passed in 2015, and a PPP unit has been created (Instance Générale des PPPs - IGPPP) at the level of the Presidency of the Government. While it plays an important role, it struggles to provide the necessary expertise in PPP transactions to inexperienced public stakeholders.

#### Sectoral (or multi-sectoral) and Institutional Context of the Program

6. Tunisia’s renewable water resources amount to 405 m<sup>3</sup>/ inhabitant/year, which is below the threshold of absolute water scarcity. Climate change is predicted to increase temperatures, reduce precipitation, and increase rainfall variability, which will result in increased water consumption and reduced supply. The Ministry of Agriculture, Hydraulic Resources, and Fisheries (MAHRF) is responsible for overseeing the water sector and for mobilizing, conserving, and managing water resources. Major infrastructure investments have allowed Tunisia to capture most of its scarce water, mobilizing close to 100% of the renewable resources. However, moving forward, additional water resources will need to be secured to augment supply while demand-side measures will be essential to keeping water use in check. All the urban population has at least basic drinking water access, while this figure decreases to 83% for the rural population. As far as sanitation is concerned, 89% of urban households use improved sanitation facilities, but this figure goes down for rural areas, where more than half of households use latrines (56%), and 20% septic tanks.
7. Société Nationale d’Exploitation et de Distribution des Eaux (National Water Distribution Utility or SONEDE) is the national public water utility providing drinking water to 100% of the urban population of Tunisia and about 50% of the rural population. Created in 1968, it has more than 2.7 million clients today, it distributes more than 650 million m<sup>3</sup> per year, has an annual turnover of about US\$ 170 million, and has 6,600 employees. SONEDE has developed important production, conveyance, and distribution infrastructure that have allowed Tunisia to reach high access levels at the household level without service cuts, and to provide water of good quality in line with international standards. Urban sanitation is the responsibility of the National Sanitation Utility ONAS.
8. The excellent technical results achieved by SONEDE since its creation have been threatened during the last decade by serious financial imbalances. In 2016, SONEDE received no operating subsidies, but part of its investments was covered by the State. Its debt was of 441 million Tunisian Dinars (TD), its return on equity -0.01, and the debt to equity ratio stood at 0.35. This fragile financial situation has affected the maintenance of its infrastructures and undermined necessary new investments. For example, SONEDE’s overall non-revenue water has increased from 22% in 2003 to 33% in 2016, with values above 45% in certain areas of the Center and South of the country. A key driver of this imbalance has been the increasing disconnect between tariffs and the average cost of water. Since 2006, there were tariff increases only in 2010, 2011, 2013, and 2016, and these have been insufficient to fill the financial gap. A continued deterioration of financial and operational performance could end up affecting the quality of services provided and the capacity of SONEDE to manage its assets optimally.
9. The increase in population and water demand requires large investments, especially related to reinforcement and extension of production infrastructure, such as desalination plants and water distribution networks in rural areas. For



Greater Tunis, for example, shortages are expected by 2022 if supply capacity does not increase. In parallel, SONEDE needs to increase its efforts to improve its operating revenues and its asset management, as well as modernizing its operational procedures. A company reorganization is urgently needed in the context of an aging workforce and massive departures due to retirement in the next few years. Other issues to address include operational weaknesses such as the deterioration of network performance and increasing commercial losses due to ageing water meters; lack of autonomy from the supervising authority, the Ministry of Agriculture, excessive centralization and a weak focus on customer services.

10. The Government and SONEDE have prepared the Water Supply Security Program (WSSP) with the following three objectives:
  - (i) Ensuring the long-term financial viability of SONEDE and improving its operational performance
  - (ii) Improving the quality of the services provided and enhancing customer relations
  - (iii) Securing and reinforcing access to drinking water at the national level
11. The WSSP cost is estimated at 4 billion Tunisian Dinars (\$ 1.5 billion at today's exchange rate) and is based on the following two pillars: (i) WSSP's Reform Strategy and (ii) an investment program to secure and reinforce drinking water infrastructure. The WSSP is aligned with the "Reform Strategy for SOEs" approved by the GoT in 2015. The objectives of the WSSP include modernizing the utility, reinforcing the quality of services offered to clients, and ensuring its financial viability and the preservation of its assets. This is to be done by implementing an action plan based on improvements in operations, assets management, commercial management, financial management, IT services and human resources management. The investment program includes investments in the mobilization of non-conventional brackish and sea water through desalination; reinforcement of the water supply network; incorporating part of the rural areas into SONEDE's network; improvement of the performance of conveyance and distribution networks; and reinforcement of production systems.

#### Relationship to CAS/CPF

12. The proposed Program is aligned with the 2016-2020 Country Partnership Framework (CPF), which is based on the following three pillars: (i) restoring an environment conducive to sustainable economic growth and private sector led job creation; (ii) reducing regional disparities; and (iii) promoting increased social inclusion. The proposed project is explicitly included as a fiscal year 2018 deliverable under pillar II, particularly through the angle of improving access to and quality of services in lagging regions.
13. The proposed project contributes to all three CPF pillars through: (i) improving the enabling environment for private sector participation by improving the creditworthiness of SONEDE (CPF pillar 1); (ii) improving access and quality of water service delivery in lagging regions (CPF pillar 2); and (iii) increasing the accountability between the SONEDE, GoT, and its citizens (CPF pillar 3). In addition, the project is fully embedded in a governance lens, which is the first foundational theme of the CPF.
14. The Program is aligned with the WBG MENA Strategy "Economic and social inclusion for peace and stability" by supporting its first pillar on renewing the social contract. The project aims at ensuring sustainable drinking water services to the population of Tunisia, thus reinforcing citizens' trust in public sector capabilities. It also aims at improving two channels of accountability: (i) between SONEDE and its clients by granting the former more operational autonomy; and (ii) between SONEDE and GoT by agreeing on specific performance improvement objectives.
15. The Program is also aligned with the maximizing finance for development approach, which aims at promoting the



judicious use of scarce public and concessional resources to crowd-in commercial capital and minimize the public debt burden on clients, while delivering sustainable and affordable infrastructure services. This project aims at putting in place sector reforms which include regulatory, pricing, and institutional mechanisms that should improve the credit-worthiness of SONEDE, facilitating its access to commercial financing in the future.

#### Rationale for Bank Engagement and Choice of Financing Instrument

16. The Bank has a longstanding partnership with SONEDE based on financing basic infrastructure. The “Urban Water Supply Project”, which consisted of a loan to SONEDE, was approved in 2005 and an additional financing was approved in 2014. The project closed on June 30, 2018 and a completion report is under preparation. It has resulted in significant achievements in terms of rehabilitating the water distribution networks in a number of medium sized cities as well as maintaining 24/7 water supply to Greater Tunis, despite an important increasing demand. However, the Bank and other donors’ financing has not managed to help SONEDE recover from the above-mentioned challenges experienced in recent years and its financial situation is currently delicate.
17. The Bank has recently taken a number of actions that go beyond lending to help SONEDE improve its performance. First, in 2014 it co-organized with SONEDE a donors’ conference in Marseille in which investment needs of the WSSP worth US\$ 1.5 billion were presented to a number of donors who provided in principle agreements to finance specific projects. Second, in 2015-2016, the Bank financed a detailed study to provide a pathway for SONEDE to get back to financial equilibrium, by combining several measures from both SONEDE and GoT sides, which has been a key input into the reforms included in the WSSP.
18. Based on a detailed assessment of the WSSP and discussions with counterparts, the financial instrument proposed to finance this project is the Program-for-Results (PforR) for the following reasons:
  - Government program. The Government and SONEDE shared a request with the Bank to support a clear Government program, the WSSP, with clear objectives and means (both physical and soft) to achieve those objectives. The WSSP has been approved by the Board of SONEDE (in February 2018) and by its direct counterpart in the Government, the Ministry of Agriculture. A Government meeting (Conseil Ministériel Restreint) to discuss the drinking water sector, where this program is expected be endorsed, is scheduled for Fall 2018and. The PforR is the appropriate instrument in this context as it is linked to a global Government program and not to specific transactions.
  - Implementation of reforms. The PforR supports the implementation of institutional reforms. These reforms will lead to the modernization of SONEDE, improvement of information systems, reinforcement of the quality of services offered to clients, stronger financial viability and optimized management of its assets. Without these reforms, the financial sustainability of SONEDE will be compromised and the quality of services to clients could decrease drastically in the next few years.
  - Government systems. The PforR uses Government systems (financial management, procurement, and social and environmental safeguards). The preliminary technical, fiduciary, and safeguards evaluations have shown that: (i) the investments that are part of the expenditure framework are technically sound and relevant at the strategic level; (ii) the successful implementation of investments will require strong incentives, support measures, and reinforcement of institutional capacities to overcome some of SONEDE’s difficulties in implementing IPFs in the recent past; and (iii) the evaluation of SONEDE’s systems on procurement, financial management and safeguards has shown that they are globally aligned to international good practices provided some adjustments are put in place, which will be done through the program action plan (PAP).



- Disbursements linked to results. The PforR only disburses once results are achieved. Given SONEDE's current financially fragile position and the reforms needed to overcome this situation, strong incentives are needed for both the Government and SONEDE to implement some short-term difficult reforms that will pay off in the medium term. The fact that the PforR disburses based on verified results – and not simply on inputs – is a strong incentive to take decisions that are essential but not necessarily easy to implement.

### **C. Program Development Objective(s) (PDO) and PDO Level Results Indicators**

#### Program Development Objective(s)

19. To improve SONEDE's financial and operational performance and the quality of service to customers, and to secure water supply in Greater Tunis and diminish losses in selected Central and Southern Governorates.

#### PDO Level Results Indicators

20. The proposed PDO indicators are (i) operating ratio (%); (ii) debt ratio (%); (iii) resolution of clients' complaints in 24 hours (%) (iv) population of Greater Tunis receiving 24/7 water service; (v) water volumes saved in Central and Southern Governorates; and (vi) direct project beneficiaries (number) of which female (%).
21. The Program will support the following three results areas:
  - i. Ensuring the long-term financial viability of SONEDE and improve its operational performance;
  - ii. Improving the quality of the services provided and enhancing customer relations; and
  - iii. Securing long-term water supply for Greater Tunis and promoting the efficient use of water in selected Central and Southern Governorates.
22. Below is a (non-exhaustive) list of preliminary indicators (development objective and intermediary indicators, as well as outputs) by result area that have been identified to measure achievements. During preparation, decisions will be taken on which indicators will be used as disbursement linked indicators (DLIs), which ones will be absorbed into the program action plan, and which ones will simply be included in the program's results framework. The initial set of indicators have been identified based on the technical assessment of the program and will be discussed in detail with the GoT during preparation.

#### Results Area 1: Ensuring the long-term financial viability of SONEDE and improve its operational performance

1. Operating ratio (%)
2. Debt ratio (%)
3. Water tariffs adjusted annually on the basis of an agreed financial model's results
4. Collection rate
5. Performance contract between the State and SONEDE signed
6. SONEDE benefits from a derogation to law 89-9 (through article 22 ter) to have more operational flexibility

#### Results Area 2: Improving the quality of the services provided and enhancing customer relations

1. Resolution of clients' complaints in 24 hours (%)
2. Preparation and implementation of a grievance redress system at the central and regional levels
3. Preparation of a communication and information strategy
4. Updated SONEDE organigram approved (including the creation of a Commercial Division)



5. Rate of subcontracting studies to prepare and supervise investment projects (preliminary studies and technical specifications)
6. Tender process for a pilot desalination BOT transaction launched

Results Area 3: Securing long-term water supply for Greater Tunis and promoting the efficient use of water in selected Central and Southern Governorates

1. Population of Greater Tunis receiving 24/7 water service
2. Water volume saved in selected Central and Southern Governorates
3. Additional water volume produced for Greater Tunis
4. Non-revenue water in selected Central and Southern Governorates

#### **D. Program Description**

##### PforR Program Boundary

23. The Government and SONEDE have developed the Water Supply Security Program (WSSP) with the following three objectives: (i) ensuring the long-term financial viability of SONEDE and improving its operational performance; (ii) improving the quality of the services provided and enhancing customer relations; and (iii) securing and reinforcing access to drinking water at the national level. This PforR will support the first 2 objectives as well as part of objective 3 - namely, securing water supply in Greater Tunis and diminishing losses in Central and Southern Governorates.
24. The WSSP's Reform Strategy aims to strengthen the company's capacity and administrative autonomy, improve its operational performance and restore its financial equilibrium. It also aims to modernize the company, strengthen the quality of the services offered to its clients and guarantee its financial viability and the preservation of its assets. This strategy will require a clear commitment of both the Government and SONEDE to be effectively deployed.
25. The WSSP's investment program is estimated at 4 billion Tunisian Dinars (US\$ 1.5 billion) and comprises 9 sub-components (see table 1). The main components of the WSSP are already funded by other donors, with the exception of (i) securing of drinking water in Greater Tunis; and (ii) the water savings component, which aims at improving network performance, which has deteriorated significantly over the past decade. The proposed PforR will support investment related to Greater Tunis (component A), investment related to the reduction of water losses in the South and Center of the country (component G), and the financing of envisaged reforms (component I).
26. The proposed PforR will finance US\$ 150 million of the WSSP through a three-pronged approach focusing on three Results Areas:
  - Results area 1 will promote actions to improve the long term financial viability of SONEDE and enhance its organizational performance. These actions include not only tariff increases but also the adoption of a financial model to make tariff adjustments more objective and predictable – as opposed to the ad hoc manner today – and introducing indexation formulas to link tariffs to the evolution of the costs of inputs (e.g. electricity prices). This results area will also focus on improved internal financial management and analytical accounting. Finally, this results area will include the preparation and signature of a performance contract between the State and SONEDE, as well as potentially granting SONEDE more operational flexibility.
  - Results area 2 will focus on improving the quality of the service provided and enhancing customer service. The broad objective is that SONEDE becomes more client oriented and able to react in an agile manner to complaints from





customers. Actions towards this goal could include the creation of a commercial division, an update to SONEDE's organigramme, and implementing a grievance redress mechanism. There are also other measures that could help improve the quality of the services provided, and these include externalizing some studies related to investments for which SONEDE does not necessarily have a comparative advantage, or identifying when public-private partnership solutions can be more efficient in delivering water services, with a focus on desalination plants and the Mahdia plant, which is currently planned as SONEDE's first BOT.

- Results Area 3 aims to cover the growing demand for drinking water in Greater Tunis, and to support the efficient use of water resources in the Center and South of the country, where water is particularly scarce and its marginal cost is high – given that desalination is playing an increasing role. In Greater Tunis, if the current capacity is not expanded, water shortages are expected to become a reality by 2022. A new water production plant will be built West of Tunis (Bejaoua) where the Government is completing a large water transfer and storage infrastructure conveying raw water from the North of the country where surface water resources are available. The new plant will cover the growing water demand of the population of Tunis and surrounding municipalities and will supply a large economic and social area under development (Tunis Financial Harbor). The rehabilitation of the existing water production plant, in particular of two units built in 1970 and 1983, will contribute to securing the long-term availability of water production from this plant. Reduction of non-revenue water will be achieved by reducing both physical and commercial losses in selected Central and Southern Governorates. Some of these Governorates currently have losses that are as high as 50%, and losses have increased substantially over the last decade. There are on-going discussions to put in place a performance-based contract with a private operator for Greater Sfax, which would include the following activities: detecting and repairing of leaks, network management improvement, pipeline rehabilitation, replacing service connections and faulty water meters and customer database upgrading.
27. A set of intermediate indicators will be identified and defined during preparation to measure and track intermediate results or intervening steps towards the PDO, including indicators to ensure the application by both parties – the Government and SONEDE - of the performance contract, such as periodic tariff adjustments, water loss reduction in the Center and South, and meeting increased water demand in Greater Tunis. Two types of indicators will be carefully defined in consultation with MDICI, MAHRF, Ministry of Finance, and SONEDE: those that are linked to disbursements, referred to as “disbursement-linked indicators” (DLIs) and those referred to as “other intermediate results indicators” that are not linked to disbursements. The achievement of DLIs will trigger Bank disbursements to the Program and once disbursed, Bank funds will supplement resources from the GoT and SONEDE to implement all Program activities linked to the above results areas.

## E. Initial Environmental and Social Screening

*[Potential environmental and social effects; knowledge and general understanding of the Program system to manage environmental and social risks and impacts; and timeframe for launching the E&S systems assessment including consultation on and disclosure of the draft systems assessment]*

28. The environmental risk rating is Moderate. The program's investments are not expected to induce any long term or irreversible environmental or social impacts. Potential adverse environmental and social impacts/risks are anticipated to be limited in scope and be workplace specific. As such, they will be managed on workplace sites.
29. The social risk rating is Moderate. The investments under the program are not expected to have significant adverse social impacts. The investments would include the construction of the water treatment plant, the rehabilitation of SONEDE's network in selected areas to reduce technical losses and replacing and fixing meters to reduce commercial



losses. While these construction related activities could potentially involve in land acquisition but social impacts/risks would be limited and manageable. The reform part of the program, which consists of enhancing SONEDE’s financial, commercial and administrative performance may not result in any adverse social impacts.

- 30. An Environmental and Social System Assessment (ESSA) will be prepared, consulted upon, and disclosed prior to appraisal. The ESSA will examine the scope, context and potential impacts of the Program from an environmental and social perspective. It will entail the review of environmental and social management systems and of the implementing capacities of the respective government agencies that will participate in the Program and evaluate their consistency with the core principles and attributes specified in OP 9.00. The content of the ESSA will include, but not be limited to: (i) a brief description of the Program, including the objectives, relationships between government’s Program and the PforR; (ii) potential environmental and social risks, impacts and benefits, including any potential issues related to land acquisition; (iii) institutional arrangements and mechanisms in place to deal with the potential environmental and social risks; (iv) identification of areas in which the implementing entities should improve procedures and performance and (v) inputs to the integrated risk assessment.
- 31. Category A-type interventions are excluded. Program investments will nevertheless be carefully screened to assess if any Category A-type interventions are included. Such investments will not be part of the program, as stipulated in OP/BP 9.0, and accordingly the team will make sure that planned investments do not cause any significant adverse environmental or social impacts that are sensitive, long-term or irreversible and that such impacts are site specific, mostly reversible and can be effectively mitigated with local resources.

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