Report No. PID10803

Project Name	Tunisia-Third Municipal Development
Region	Middle East and North Africa Region
Sector	Sub-national government administration (50%); Roads & highways (50%)
Project ID	TNPE74398
Borrower(s)	CPSCL
Implementing Agency	CPSCL/MINISTRY OF INTERIOR Address: 8, rue de Médine, 1002 Tunis, Tunisia Contact Person: Mr. Mohamed Zakhama Tel: 216/71/798.600 or 353.262 Fax: 216/71/809.040 Email: cpscl@email.ati.tn DGCPL/Ministry of Interior Address: 1, rue Moasker, Le Passage, 1000 Tunis, Tunisia Contact Person: Mr. Mohamed Belkhiria Tel: 216/71/354.500 or 333.000 Fax: 216/71/353.109 or 350.309
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1. Country and Sector Background

The Primacy of Tunisia’s Urban Areas: Tunisia is among the most urbanized countries in the Middle East and North Africa Region. Presently, 64% of the population live in cities and towns, the vast majority of which are in cities with over 50,000 inhabitants. Between 1995 and 2000 urban population grew by 3.35% and is projected to reach 70% by the year 2020. This demographic pressure will create further demand on municipalities to provide and maintain basic services. The incomplete evolution of the Municipal Sector: The Tunisian municipal sector has well evolved over the last decade, yet its capacity to assume its investment responsibilities and respond to the increased demand for services is still at a relatively early stage of development, and needs to be reinforced. Tunisian municipalities remain fairly limited in their scope of operations and finance. Their economic contribution has been growing at a slower rate than the overall economy and presently accounts for 1.5% of GDP and 5% of total public expenditures.In an effort to redistribute expenditure and service responsibilities between the State and local authorities, the GoT, with Bank support, inititated a process of restructuring of the municipal sector, in the early nineties. This restructuring was intended to provide municipalities with the means of assuming a greater role in financing their priority investments and increase investment at the local level. The CPSCL was transformed from a simple cashier's window, to a specialized financial institution that can appraise and monitor municipal investments, and assist municipalities in planning and implementing services. Interest rates on municipal loans were gradually increased to better reflect the cost of funds for CPSCL. At the same time, municipal capacity was supported by intensive training carried out by the CNPRCRM (Centre National de Perfectionnement et de Recyclage des Cadres Régionaux et Municipaux). These measures were followed by reform of local finance and the inter-governmental transfer system in the late nineties. The outcome of these efforts was a substantial level of municipal investment of about TD 860 million during the ninth Plan period (1997-2001); of this, 37% was financed by borrowing (CPSCL loans), and 17.5% by local revenues. The remaining balance of some 45% was financed through subsidies, the bulk of which were administered by CPSCL in combination with loans.The weak Financial Situation of Municipalities: Notwithstanding the increase in local revenues (through fiscal and non-fiscal revenues) and investment in the latter half of the nineties, many municipalities will have difficulty, in the future, mobilizing the resources needed to carry out investment, repay debt and maintain existing infrastructure. It is estimated that about 25% of municipalities, principally smaller communes, fall into this category, and will need to adjust both their level of investment and improve their management of resources. Others remain (about 25% also) dependent to varying degrees on capital subsidies to supplement loans.This is the reason why the Tunisian Government has created , for the tenth plan, three categories of municipalities: - 71 municipalities (at the beginning of the project) in a critical financial situation, which does not allow them to borrow. Their reduced investments will be totally financed through subsidies. - 61 municipalities (at the beginning of the project) which face financial problems. Their reduced investments will benefit of a modulated financing plan. -128 municipalities (at the beginning of the project) in a normal financial situation.To increase the capacity of municipalities to finance their own investments, either through borrowing or own resources, there will clearly be a need to increase their level of revenues, as it is unlikely that the global volume of capital subsidies administered through CPSCL can be increased. The outcome of the 1997 and 2000 fiscal reforms are still being evaluated. Preliminary indications are that the local tax reform implemented has had positive, albeit limited, effects while the financial situation of local governments still needs to be consolidated. Fiscal reforms have brought about an overall 40% increase in fiscal resources (1996-2000) primarily through the TCL (Taxe sur les Etablissements à CaractÒre Industriel, Commercial et Professionnel) and TNB (Taxe FonciÒre sur les Terrains Non-Bãtis). However, the increase has not been uniform, and tax recovery rates are still less than 50%. An additional fundamental weakness of current financial management practices is the present budgetary accounting and classification process which makes it difficult to evaluate costs of services and which registers repayment of capital (and not only interests) as operational expenditures. These issues are recognized and efforts to address them are being initiated. The limited evolution of CPSCL: As noted, CPSCL has evolved substantially over the last decade. It has maintained adequate financial performance ratios but is still dependant on official external lines of credit for its resources, and remains restricted in its freedom to approve or reject funding for projects listed in the PIC (Plan d'Investissement Communal). Furthermore, the financial weakness of municipalities, that may have over-borrowed to finance the previous PIC, is a main concern for CPSCL. The strategic study on CPSCL -- financed under the PDM-II -- recommended the transformation of CPSCL into an autonomous financial institution; yet such an objective is unlikely to be achieved without a parallel strengthening in the local government financial framework. Thus despite marked improvement in CPSCL capacity to serve municipal investment needs, its future growth is dependent not just on its own transformation and autonomy but more fundamentally on improvement in the financial situation of municipalities.The municipalities strengthening oriented Government strategy: The Tunisian government has just adopted the tenth development plan for the period 2002-2007. It recognizes that it needs to consolidate the progress made during the previous period. Municipal financial and management capacity building remains one of the priority objectives. In this overall context, and taking account of the long-term involvement of the Bank in this sector over the past decade, the Government has requested a follow-up project to build on the gains of the current project, and supports municipal development during the next Plan period. The strategic directions for the sector during the next Plan, as communicated in the draft request, include: (i) strengthening the role of municipalities in local development; (ii) continuing the reforms to enhance decentralization; (iii) quantitative and qualitative improvement in urban services as a necessary corollary to national efforts to strengthen Tunisia's economic competitiveness; (iv) increasing citizen participation in urban planning and management; (v) improving mobilization and utilization of municipal revenues through a combination of transfers, better cost recovery and collection of local taxes and fees; and (vi) reform of the CPSCL by simplification of the regulations governing credit and subsidies, enlargement of its services to include private service providers and enhancement of its ability to mobilize resources on financial markets. These strategic orientations recognize that without additional effort, it is likely that an increasing number of cash-strapped municipalities would be unable to finance new investments, or even reimburse outstanding loans.

2. Objectives
To strengthen the institutional environment for the delivery of municipal basic services and infrastructure through: (a) increasing institutional capacity of both local governments and related central agencies, and (b) enhancing the financial and institutional capacity of the Municipal Development Fund (Caisse des Prõts et de Soutien des Collectivités Locales, CPSCL) that provides financing for municipal investments.

3. Rationale for Bank's Involvement
The worldwide experience of the Bank in the municipal development sector, its long term involvement in this sector in Tunisia, its recockgnized expertise and credibility, will allow the Bank to (a) offer a comprehensive package of reforms necessary to strengthen municipalities, (b) provide access to high quality training and assistance to the different stakeholders, and (c) enhance the partnership with other donors. Both CPSCL and GoT view the Bank's loan as a critical resource to finance local investments, in a period during which CPSCL would be put on the path to becoming more independent and financially sustainable.

4. Description

1. INSTITUTIONAL STRENGTHENING OF GOVERNMENT AND PUBLIC ENTITIES:

1.1 CNPRCRM (TA): institutional reform of the training center and products and mode of delivery of training program.
1.2 Municipalities (TA, equipment and studies): assist the municipalities to strengthen their managerial and financial capacity, to provide computerization for tax collection purposes. and to further implement the GESCOM program.
1.3 DGCPL (TA): provide technical assistance for reforming their working procedures and relations with municipalities.
1.4 DGAR (TA): provide technical assistance for reforming their working procedures and relations with rural communes and regional districts.
1.5 GESCOM (TA): to further implement the GESCOM program.

2. CPSCL:

2.1 Provide technical assistance, training and studies to support its transformation into an autonomous and financially-viable institution.
2.2 Credit line to CPSCL to finance priority municipal investments.
2.3 Credit line to CPSCL to finance micro-projects

5. Financing

	Total (US$m)
BORROWER	$71.62
IBRD	$74.48
IDA	
FRANCE: FRENCH AGENCY FOR DEVELOPMENT	$45.02
Total Project Cost	$191.12

6. Implementation

Funds flow: CPSCL will be the Borrower. GoT will guarantee the loan. Moreover, CPSCL will sign a subsidiary loan with GoT to make funds available to GoT (MoI) to implement component 1 of the project.
Financing arrangements: The institutional strengthening of Government and public entities is evaluated at US$3.83 million. The government will finance 20% of this amount, the BIRD 59.3% (sub-components 1.2, 1.3, 1.4, and 1.5) and AFD 21.7% (sub-component 1.1).The institutional strengthening of CPSCL is evaluated at US$0.70 million. The CPSCL will finance 20% of this amount, the AFD will finance 80%.The priority municipal investments during the Xth national plan period (2002-2006) are estimated in aggregate at US$622.26 million. These would be financed by the municipalities from a combination of sources including: (i) own resources, central government subsidies, and national agencies participation in an amount of US$437.11 million; and CPSCL for US$185,15 million. The resources required by CPSCL are expected to be covered by a credit line from the Bank (US$72.13 million), a credit line from AFD (Agence FranÓaise de Développement) (US$43.42 million), , and CPSCL internal cash generation (US$69.61 million). The municipal investments which are not planned in this Xth national plan will be financed by the municipalities from own resources and from CPSCL loans. CPSCL has planned to borrow US$35 million on the local financial market to refinance these extra-PIC loans.
Implementation: Each component and subcomponent of the project will be implemented by the relevant entity as follows: (a) DGCPL will be

responsible for implementing the technical assistance programs for itself and the municipalities and for implementing the computerization plan of municipalities and local taxes collection centers, (sub-components 1.2, 1.3, and 1.5),(b) DGAR will be responsible for undertaking its institutional strengthening program (technical assitance, equipment and studies) to strengthen the rural communities and the regional districts (sub-component 1.4),(c) CNPRCRM will implement its institutional strengthening plan (tecnical assistance and equipment) for establishing a client-oriented training program, (sub-component 1.1), and(d) CPSCL will be responsible for evaluating and financing local government proposals for investments, following eligibility criteria for subprojects and beneficiaries satisfactory to the Bank. CPSCL municipal loan rates will be set at a level that would allow CPSCL to cover its costs and generate an adequate return on capital (sub-component 2.2 and 2.3); CPSCL will also implement its institutional strengthening plan (sub-component 2.1).Project oversight: A project coordination unit will be created in DGCPL, with one director and two managers. This unit will be responsible of the coordination and supervision of all the actions financed by the project, especially the elaboration and implementation of municipalities restructuring plans and level upgrading plans. An interministerial committee, formed of Ministries of Interior, Finance, Economic Development, and CPSCL's representatives will be created to monitor the municipalities restructuring plans. In terms of lending arrangements, World Bank funds will be credited to the CSPCL loan account (presumably at the Central Bank) in the currency in which the Bank loan is denominated. Withdrawal by CPSCL from this account would be in Tunisian Dinars (DT) at the then prevailing exchange rate. CPSCL will be charged the nominal interest rate of the World Bank foreign currency loan plus a foreign exchange risk premium. This premium will be paid to the Treasury into a guarantee fund already established by the government to cover the foreign exchange risk of CPSCL. This would ensure that CPSCL would remain on a level playing-field with all other financial institutions in Tunisia that are receipient of foreign currency loans and that pay a premium to such a guarantee fund. The premium, currently set at 1%, on the basis of the historical volatility of the DT/Euro exchange rate, would imply that the Government would be expected to be compensated for assuming the foreign exchange risk on World Bank funds - which CPSCL is no position to bear as it is a risk that it cannot transfer to its local government borrowers, nor otherwise hedge.Monitoring: The CPSCL would be responsible for maintaining books of accounts and preparation of Financial Monitoring Reports (FMR) and their transmission to the Bank on a quarterly basis. It will also be responsible for preparation of annual Project Financial Statements and their submission to the auditor. The financial management procedures, including job descriptions, internal control mechanisms, flow of funds, accounting policies, disbursement procedures and reporting will be defined in the operational manual.CPSCL will appoint an independent auditor acceptable to the Bank, to carry out an annual audit according to internationally acceptable auditing standards as issued by the International Federation of Accountants, the Bank's Guidelines and specific Terms of Reference (TORs) acceptable to the Bank. The auditor will express a professional opinion on (i) the annual project financial statements, (ii) SOEs, and (iii) Special Account transactions. The audit report, which will include three separate opinions, will be transmitted to the Bank within six months of the close of each fiscal year.

7. Sustainability

The project will build capacity of both local governments and central government entities as well as help in the transformation of CPSCL. Direct technical assistance and long-term programs of training will enable an adequate support for the Project and the sustainability of its objectives. Key factors built in the framework of the Project have been elaborated:(a) Preliminary assessments of issues, priorities and needs for training and technical assistance for each of the key stakeholders (CPSCL, DGCPL, DGAR, CNPRCRM, and municipalities) will help define client-oriented training programs and adequate objectives for consultancy work.(b) A specific set of mandatory actions for helping municipalities in difficult financial situation will ensure that municipalities would not be entrenched in their problems. These actions would consist of (i) placing municipal budget under administrative supervision, (ii) direct technical assistance for restructuring of municipal budgets and investment planning, and (iii) mandatory financial and technical management training for municipal staff. These actions will be defined by a committee made up of MoI, MoF and CPSCL representatives.(c) Long-term involvement of the Bank in the financing of CPSCL would be a valuable sign of confidence that would encourage institutional investors to extend credit to CPSCL, for instance in subscribing to bond issues by CPSCL.(d) Elaboration of mechanisms for municipalities to improve collection of own resources and strengthen their financial capacity.

8. Lessons learned from past operations in the country/sector

The Bank has learned in the design and implementation of municipal development projects how to address issues on the demand side as well as on the supply side within the sector; this has proved to be a key element for a successful and sustainable project. The proposed project will therefore address both sides:(a) On the demand side, municipalities should have the financial capacity to qualify to borrow and meet the debt servicing requirement. A thorough analysis of municipal finance has been undertaken, which has underscored the need to address the weaknesses in the institutional capacity and financial situation of local governments within the context of the proposed project.(b) On the supply side, the proposed project will seek to transform the municipal development fund (CPSCL) into an autonomous and self-standing financial institution. CPSCL should be able to raise resources on the capital markets by the end of the project period and become, in the medium term, a sustainable financial institution able to meet the demand of the local governments.More specifically, the design of the proposed project reflects the lessons learnt from the implementation of the previous Bank projects (PDM I - project outcome rated satisfactory by OED- and PDM II - being satisfactorily implemented) and the numerous studies that were/have been launched under the PDM II project.Key lessons drawn from the projects and studies are that: (i) municipalities need to generate a significant and stable level of resources through tax collection, (ii) the present system of state financial transfers needs to be further reformed, particularly in targeting poor municipalities with few resources, (iii) the system of financing local government investments needs further broadening to transform the CPSCL into a financial institution that offers a wide range of products adapted to the evolving needs of local governments and other stakeholders, (iv) alternative solutions are necessary for human resource development at the municipal, regional and national levels, (v) programs aimed at upgrading local governments should be strengthened, and adapted within their environments and, (vi) efforts toward greater consultation with and participation of the population, with a special emphasis on the poor communities need to be reinforced.The proposed project will integrate these lessons through: (i) the upgrading of municipalities' managerial and financial capacities and computerization of their tax collection, (ii) DGCPL's reform of its working procedures and relations with municipalities, (iii) DGAR's reform of its working procedures and relations with rural communes and regional districts. Also, the implementation of the recommendations of the strategic studies, financed by PDM-II, on future evolution of CPSCL and CNPRCRM for strengthening and transforming these institutions will be a critical component of PDM-III, especially the change of their legal status to ensure a greater degree of autonomy in management. The social and participatory outcome of the community participation programs financed under the PDM II will help redefine these programs to better involve community participation in municipal investment decisions and better design projects with direct impact to the population.

9. Program of Targeted Intervention (PTI) N

10. Environment Aspects (including any public consultation)

Issues : The Project is to fund the following types of infrastructure investments: urban roads and sidewalks; water distribution, drainage, sewerage, street lightening, green and recreational areas, landfills and low-income neighborhood upgrading. CPSCL is responsible for the financing of these investments and their environmental soundness.Although it is not expected, the project could, in certain circumstances, result in adverse environmental impacts. A process to ensure that potential environmental risks of subprojects are adequately assessed and managed will be established. The environmental assessment, which will be carried out during preparation under a PHRD grant, will review all the environmental aspects of the project and ensure that relevant environmental measures are integrated within the design of the project, or undertaken by other administrations. Arrangements for supervision of the environmental aspects will be detailed.The environment assessment will (a) review the environmental work undertaken under PDM-II focusing on the subprojects financed by CPSCL; and (b) identify improvements and amendments to the operational manual, with the aim of ensuring that environmental measures are integrated within the subprojects, and that subprojects comply with Tunisian law and regulation. The institutional and monitoring arrangements for the implementation of the environmental work will be detailed. Comprehensive TORs have been prepared for the undertaking of this environmental assessment (EA) during project preparation.

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Note: This is information on an evolving project. Certain components may not be necessarily included in the final project.

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